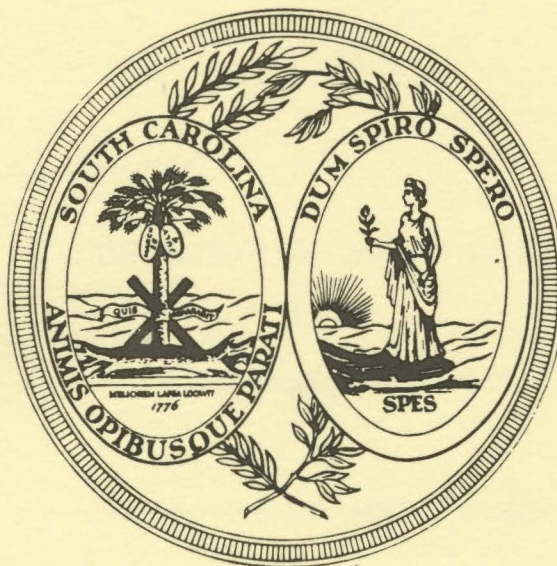


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# South Carolina General Assembly



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The State of South Carolina  
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A Management and Performance  
Review of the South Carolina  
Tax Commission  
October 29, 1986

**THE STATE OF SOUTH CAROLINA**

**GENERAL ASSEMBLY**

**LEGISLATIVE AUDIT COUNCIL**

**A MANAGEMENT AND PERFORMANCE REVIEW OF THE**

**SOUTH CAROLINA TAX COMMISSION**

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## REPORT SUMMARY

The South Carolina Tax Commission is responsible for administering and enforcing the tax laws of the State of South Carolina. In FY 85-86, the Commission collected over \$2 billion from individual, corporate, sales, and other taxes.

During the course of this audit, the Council found that the Tax Commission had not ensured compliance with certain tax laws. Agency management must be committed to improvements to restore confidence in the state's tax system, reduce taxpayers' frustration caused by Commission mistakes, and better ensure tax compliance. By Commission estimates, and a 1984 independent study of the Commission, \$99 million is being lost annually because of the inability to administer tax laws and properly monitor taxpayers. This figure does not take into account the increases in compliance which should be realized if enforcement deficiencies are corrected. The following problems must be addressed by management.

### **Tax Enforcement Problems**

- The Commission violated several provisions of the amnesty legislation. Against state law, personal checks and part-pay agreements were accepted. Later, taxpayers defaulted on over \$700,000 in agreements, and \$200,000 worth of checks bounced. Also, approximately \$1 million in taxes due during amnesty were collected under amnesty, a violation of state law (see pp. 7-10).
- After amnesty, the Commission has not cracked down on delinquent taxpayers as promised. Individuals and businesses writing bad checks, or those not paying installments as promised had not been pursued for collection or turned over for prosecution as the Commission stated would happen (see p. 11).
- Delinquent taxpayers not filing under amnesty had not been adequately pursued. One company, owing over \$33,000 in back taxes, did not file for amnesty. As of April 1986, the company was still in business and had not paid the taxes due. Another company owing over \$15,000 in withholding taxes since 1984 still operates

without paying taxes owed the state. As of April 1986, over \$22 million in delinquent taxes was outstanding (see p. 12).

- The Commission has not developed a system to select audits for individual, sales, domestic corporate, and other taxpayers. Tax auditors have no criteria for deciding which taxpayers to audit, or which audits will be most productive (see p. 15).
- The Commission has allocated more resources in miscellaneous taxes (bingo, admissions, etc.) than in sales tax, although sales tax audits were 26 times more productive. This is because the Commission does not have a plan or system to assign auditors to audits with the greatest probability of yielding large assessments. Thus, the number of audits conducted for the major taxes has been low (see p. 16).
- Tax auditors spent approximately one-half (49%) of their time on nonaudit functions between January 1985 and March 1986. If auditors spent 75% of their time auditing, an additional \$11 million annually could be assessed taxpayers not paying taxes legally owed the state (see p. 18).
- Negligence penalties assessed taxpayers found underreporting taxes due have been waived for questionable reasons. In one case, the Commission agreed to waive over \$78,000 in penalties and interest if the taxpayer would pay the taxes owed. Negligence penalties were routinely waived even before the state's amnesty program began (see p. 21).
- Since 1981, Commission errors have caused over 25,000 tax liens to be filed against taxpayers with no liability. The Commission has not corrected the problem of warrants (liens against property) being filed against taxpayers with no tax liability (see p. 25).
- The Commission does not forward to outside prosecutors most suspected tax evasion cases. Only those they consider to warrant prosecution are forwarded. Professionals, such as lawyers and accountants, have been found not to file their individual tax returns for up to seven years, but have not been recommended for prosecution (see p. 27).
- The Tax Commission has no method of assuring that taxpayers who have been investigated by its Criminal Intelligence Division continue to file returns after the close of the investigation, or pay the taxes they owe (see p. 31).

- The Commission found several high-level employees purchasing automobiles and obtaining other services from a company while they were waiving negligence penalties against that company for not paying withholding taxes. Although an internal investigation indicated wrongdoing, the case was not referred outside the agency for review (see p. 35).

### **Administration of Tax Laws**

The following problems with the administration of tax laws must be corrected to better ensure compliance with state tax laws.

- Penalties of \$1.6 million have not been assessed retailers failing to pay their sales tax, in advance, as required by law (see p. 41).
- Retailers granted "permanent" extensions to pay their sales tax late have not been monitored to ensure interest is paid as required by law (see p. 53).
- Commission records indicate that approximately 7,000 corporations did not file income tax returns in 1983 and/or 1984. Although these corporations were assessed taxes and penalties of over \$6 million, no efforts to enforce collections were made (see p. 59).
- The Commission has not ensured individuals granted an extension to file their returns do actually file. Examples of individuals not filing a final return were found (see p. 63).
- The abandoned property program needs improvement. Unreported abandoned property of \$20 million may exist (see p. 66).

### **Administration**

An examination of the Commission's administration, computer technology, and recent tax reforms revealed areas where improvements could benefit the state.

- State agencies are required to pay sales tax on purchases. This causes the state to lose over \$1 million annually because retailers do not have to repay to the Commission all sales tax collected. Also, interest is lost on sales tax that is held and then paid back by retailers (see p. 73).
- The Commission did not adequately research the individual income tax reforms implemented for tax year 1985. Although the reforms simplified filing

procedures, the Commission did not adequately prove the reforms were revenue neutral (see p. 75).

- The Commission avoided making computer changes to its present system. A new system is being developed, but is not planned to be completely operational until 1991. In the meantime, certain tax laws will continue to go unmonitored and unenforced (see p. 79).
- Tax return information is not updated in a timely manner. This causes taxpayers who have paid their taxes to be improperly notified of nonpayment (see p. 81).

Unlike other state agencies, the Tax Commission's main objective is to collect revenue for the state. The number of auditors and collectors has a direct impact on revenue collection. Existing resources, if used correctly, will generate additional revenue for the state. Likewise, adding resources will generate additional revenues. For example, each revenue office assigned to enforce warrant collections averaged over \$440,000 in delinquent collections in FY 84-85. Auditors, when provided with audit leads and the time to audit, will generate additional revenues. Therefore, it is important for the Commission to be properly staffed. Before additional resources are added, the Commission must correct problems causing inefficiencies in auditing, collecting, administration of laws, and other areas.

The Commission recognized certain problems addressed in this report and began corrective action before and during the Council's review. In 1983, the Commission recognized its computer inadequacies and began planning and developing a system to better meet the needs of the agency. Prior to 1983, according to the Commission, Tax Commission field auditors did not even have portable calculators. Now, field auditors have wide access to portable computers.

The Tax Commission has reorganized along functional lines. In order to promote efficiency, auditors and revenue agents are being cross-trained to work with all types of taxes. In addition, new field offices have been added to



better serve the agency and the public. Corporate auditors are now permanently located in certain major out-of-state cities such as Chicago and New York. According to the Tax Commission, this saves the expense of requiring South Carolina based auditors to travel to these cities.

The Commission has also implemented new procedures intended to streamline delinquent tax collection. Starting January 1986, sales tax delinquencies were forwarded to the telephone collections department for telephone contact prior to enforcement action.

The Tax Commission obtains Revenue Agents' Reports (RARs) from the IRS when it audits a South Carolina taxpayer and finds an increased federal tax liability of an amount specified by the Commission. The Commission then reviews the individual's state return, makes adjustments, and bills the taxpayer accordingly. Commission records indicate an increase of 143% in the use of RARs in the last three years. Other improvements have been planned and are being implemented by agency management.

The following chapters discuss, in detail, the operational deficiencies found during this audit of the Tax Commission. The terms Tax Commission and the Commission are used interchangeably throughout the report. A glossary of legal and technical terms used in this report is presented as Appendix C on page 95.

### **RECOMMENDATIONS**

THE TAX COMMISSION SHOULD ENSURE THAT AGENCY DEFICIENCIES ADDRESSED IN THIS REPORT ARE CORRECTED. A CORRECTIVE ACTION REPORT SHOULD BE REQUIRED TO BE SUBMITTED TO THE HOUSE WAYS AND MEANS COMMITTEE, THE SENATE FINANCE COMMITTEE, AND THE BUDGET AND CONTROL BOARD WITHIN ONE YEAR.

THE CORRECTIVE ACTION REPORT SHOULD  
INCLUDE A STAFFING PLAN TO MAXIMIZE  
AUDIT COVERAGE, DELINQUENT COLLECTIONS,  
AND OTHER REVENUE PRODUCING FUNCTIONS.

**CHAPTER I**  
**ENFORCEMENT MANAGEMENT - AUDITS, COLLECTIONS, AND**  
**CRIMINAL INVESTIGATIONS**

The Tax Commission's Field Services Division is responsible for conducting audits on selected taxpayers. Approximately 120 auditors are stationed throughout the State in nine field offices and in certain large out-of-state cities, such as Chicago and New York. The Council visited four district offices responsible for 16 counties to examine functions and discuss operations.

The Collections Department is responsible for collecting delinquent taxes owed the State. Approximately 80 revenue officers are stationed in nine field offices. The Commission has authority to close a business, garnish wages, seize property, and take other necessary enforcement actions when taxes are not paid.

A review of these functions indicates major changes must be implemented to allow for an effective enforcement program. Additionally, changes are necessary in CID's handling of cases referred for investigation.

**Tax Amnesty Program**

An examination of the Amnesty Program showed that the Commission violated several provisions of state law while administering the Amnesty Program. In addition, after amnesty, the Commission has not always taken adequate action against taxpayers who owed delinquent taxes but did not apply for amnesty or those violating amnesty agreements. This is contrary to Commission statements that after amnesty, the Commission would crack down hard on delinquent taxpayers by closing businesses and prosecuting evaders. By not strictly enforcing tax laws after amnesty, delinquent taxpayers and tax evaders are even less likely to comply with tax laws.

The South Carolina Tax Amnesty Program, conducted from September 1, 1985 to November 30, 1985, permitted taxpayers to voluntarily pay back taxes without penalties or criminal prosecution. Press releases issued by the Commission indicate that over \$8 million was collected by the Amnesty Program. A computer printout provided by the Tax Commission documents \$5.1 million collected. These issues are discussed in detail below.

### **Payments Due During Amnesty**

Against state law, late payments and other payments which became due during and after the amnesty period were accepted under the Amnesty Program. According to agency records, approximately \$1 million not qualifying for amnesty was accepted by the Commission, thereby overstating amnesty collections.

Sales, use, withholding, and miscellaneous tax returns, and payments due between September 1985 and December 1985 were granted amnesty. In essence, the Commission allowed some taxpayers to stop paying taxes that became due during amnesty, and apply for amnesty to later pay those back taxes without penalty.

Section 12-3-260(H) of the South Carolina Code of Laws did not allow payments due during the amnesty period to be accepted as amnesty.

Following are examples of payments made as amnesty which did not qualify:

- A delinquent October 1985 sales tax return, due on November 20, 1985, was collected under amnesty. The tax due on this return was \$80,000. (A penalty of over \$4,000 was not applied as required by law.)
- One company's use tax payment (\$42,000), due on October 20, 1985, was filed under amnesty.
- A withholding tax payment of approximately \$10,000, due in October 1985, was collected under amnesty.

- The bingo tax payments of a business, due during and after the amnesty period, were accepted as amnesty payments. The amount of tax was \$3,000.

### **Personal Checks**

In violation of state law, the Tax Commission accepted personal checks under the Amnesty Program. As a result, the Commission received \$195,000 in bad checks related to amnesty. There is no evidence the Commission has taken steps to collect these bad checks.

An examination of amnesty checks revealed that five taxpayers wrote a total of \$7,000 in personal checks when their bank accounts were closed. One company placed a stop payment on a \$2,500 check after applying for amnesty.

Section 12-3-260(F) of the South Carolina Code of Laws states "Payments made by a taxpayer under amnesty must be by certified check or money order." [Emphasis Added] In addition, a Commission policy states that the agency will not accept personal checks for amnesty payments. Further, this policy suggests that taxpayers filing on the last day of the amnesty period (a Saturday) should make arrangements to prevent payment by personal check. As a result, the Commission must spend additional staff time after amnesty to try to collect taxes, penalties and interest which should already have been paid.

### **Audits Conducted During Amnesty**

The Commission included collections from audits, conducted between September 1985 and November 1985 (the amnesty time period), in the amnesty totals. In some cases, these amounts included payments which were due during amnesty. The Commission was unable to provide total collections from audits which were completed during amnesty.

State legislation required that the Commission grant amnesty to taxpayers who voluntarily paid all previously assessed tax liabilities. [Emphasis Added] This

legislation also stated that liabilities due during amnesty did not qualify for amnesty consideration.

### **Tax Case Investigated and Prosecuted**

The Tax Commission permitted a taxpayer under investigation for tax evasion, to plead guilty to resolve the case under amnesty. This case, prosecuted during the amnesty period, involved \$68,500 in delinquent sales tax. The court ordered the defendant to pay the tax by November 30, 1985.

A review of the Commission's minutes indicated that the subject of prosecution would be allowed to plead guilty to settle the case during amnesty. Also, according to the minutes, the Commission approved acceptance of the case under amnesty.

Section 12-3-260(D) did not permit the Commission to grant amnesty to any taxpayer who was the subject of a state related criminal investigation or criminal prosecution.

### **Part-Pay Agreements**

The Tax Commission, in violation of the amnesty legislation, authorized part-pay agreements under amnesty. According to the Commission, \$1.2 million was authorized to be paid by installment. As of June 1986, over \$720,000 in agreements had been defaulted on, that is, the taxpayers have not met the terms of the agreements.

Some taxpayers who were authorized to make amnesty payments by installment either made a payment with a bad check, or did not make the required payment. As of June 1986, the Commission had not taken action against these taxpayers (see p. 11).

Section 12-3-260 of the South Carolina Code of Laws states that the Tax Commission shall grant amnesty to taxpayers who voluntarily filed all delinquent tax returns and paid in full all taxes and interest due.

[Emphasis Added] Further, the South Carolina Tax Amnesty

Manual stated that there would be no installment payment plan under amnesty.

Examples of amnesty part-pay agreements granted by the Commission are as follows:

1. A taxpayer, owing \$2,135 in individual income tax, was authorized to pay approximately \$25 monthly for 86 months.
2. Another taxpayer, indebted to the Commission for \$1,227, was approved to pay \$41 for 30 months.
3. A business, owing the Commission a balance of \$17,977 in sales tax, agreed to pay \$350 a month for 58 months.

If taxpayers follow the terms of their agreements, these and other part-pay agreements authorized by the Commission will require staff to work, in part, with amnesty up to seven years.

#### **Collection Efforts After Amnesty**

The Tax Commission's efforts to collect delinquent taxes owed to the state have not significantly improved or changed after the amnesty time period. These problems are discussed below.

#### **Amnesty Agreement Violations**

During amnesty, the Commission improperly allowed businesses and individuals to enter into agreements to pay back taxes over a specified time period and avoid penalties and prosecution (see p. 10). If any payment was late, the Commission stated the agreement would be rescinded, all penalties would be applied, the business license could be revoked, and the subjects could face criminal prosecution. As of June 1986, approximately \$195,000 worth of bad checks were written and \$720,000 of installment payments were not made. However, the Commission had taken no action to rescind the amnesty agreements and collect taxes, penalties and interest owed, or prosecute tax evaders during the

Council's review. Records were kept in Columbia and not sent to the field for collection.

Some businesses are still operating without paying sales and withholding taxes, and the Commission has not actively pursued collection, closing the businesses, or prosecution. For example:

- An attorney who had not filed individual tax returns for nine years or paid withholding tax for his employees since 1975, filed an amnesty agreement. He promised to pay taxes owed, but only made partial payments for two months. No action had been taken by the Commission although the attorney still owed over \$3,600.
- A company promised to pay over \$56,000 in corporate income and withholding taxes by February 1986. The company paid none of the taxes, and the Commission had not attempted collection.
- One business owing more than \$22,000 had not paid sales taxes for at least seven reporting periods. The company filed an amnesty agreement to pay over a period of time, but had paid none of the taxes owed.
- In another instance, a taxpayer, owing \$14,251 in delinquent individual income taxes for 1983, 1984 and 1985, wrote two bad checks for \$8,491 and \$5,760.
- A business owed \$9,190 in sales tax for nine reporting periods. Although the owner of the business stated that he borrowed \$3,000 to make a partial payment under amnesty, he wrote a bad check for \$2,298.
- A taxpayer, owing \$9,260 in corporate income tax for 1983, was authorized to pay under an amnesty part-pay agreement. The taxpayer wrote a bad check for \$1,000, and had not, as of April 1986, paid any of the amnesty agreement.

#### **Taxpayers not Filing for Amnesty**

Taxpayers not filing under amnesty to pay all back taxes have not been adequately pursued. As of April 1986, over 31,000 warrants for over \$22 million in back taxes were outstanding. (This excludes delinquent taxes not yet in warrant status.) The Commission has not "gotten tough" and required that individuals and businesses either pay taxes



owed, or have their property seized, and/or lose their license to conduct business as the Commission had stated would happen. No cases examined had been referred for criminal investigation for failure to pay taxes due.

The Commission has taken steps to garnish wages when it is known where a taxpayer works. Other collection efforts have been modified. However, there is no evidence the Commission has taken other "tough" enforcement action, or sought criminal prosecution for nonpayment of taxes as promised would happen. Following are examples of companies owing back taxes that did not file under amnesty:

- One company owed the Tax Commission over \$33,000 in delinquent sales, withholding and corporate income taxes. Although the company had seven outstanding warrants and was still operating, the Commission had not taken action to ensure payment of taxes or revoke the company's license. When withholding taxes are not paid, the state loses in two ways. First, the tax is not collected. Second, employees can file an income tax return and receive a refund on money never paid into the system.
- One company has not paid over \$15,000 of withholding taxes dating back to 1984. Commission records indicate this company is still in business.
- A business with a history of delinquencies owes over \$3,800 in back taxes. The business is still operating, although it has not paid all taxes owed.
- Another company has owed over \$9,000 in withholding taxes for over a year. Although a warrant officer made contact with the taxpayer twice in 1986, no money had been collected.

Public statements released by the Commission stated "Beginning Dec. 1, 1985, the South Carolina Tax Commission is going to crack down hard on delinquent taxpayers and evaders." The Commission also stated that after amnesty, tax evaders are going to have to face the consequences of their crime, "We've got the resources to enforce the tax codes."

Also, effective September 1985, state laws were amended to allow the Tax Commission to close a business for any

outstanding tax liability. Additional laws were enacted to assist the Commission's collection efforts, including making it a felony to evade taxes.

When the Commission does not use all available techniques to enforce payment of back taxes, as promised, revenue due to the state is not collected. Uncollected outstanding warrants have increased by 32% to approximately \$25 million after amnesty ended. Tougher enforcement laws are meaningless if the Commission does not enforce them as promised.

### Conclusion

A review of the Amnesty Program indicates that over 97% of the taxpayers filing under amnesty owed delinquencies identified by the Commission before amnesty began. These delinquencies were already on the Commission's records of outstanding debts. Amnesty gave these debtors an opportunity to avoid paying over \$1 million in penalties by paying what was already identified as owed. These funds could have been collected without amnesty.

Further, some of the cost resulting from amnesty are as follows.

- Refunds - \$240,000.
- Staff time - \$127,000.
- Advertisement - \$152,000.

Also, a large portion of the revenue collected under amnesty was not eligible for acceptance under the amnesty legislation. The total amount could not be determined because an adequate audit trail was not maintained. However, the following is a summary of some funds which should not have been accepted under amnesty.

- Taxes due during amnesty - \$1,000,000.
- Personal checks which "bounced" - \$195,000.
- Part-pay agreements - \$1,200,000.
- Court ordered restitution - \$68,000.

The amount of uncollected outstanding warrants has increased by 32% to \$25 million in the eight-month time

period after amnesty ended. Those violating agreements to pay under amnesty, as well as those not filing, must be aggressively pursued to help the Commission gain a reputation as a firm and fair tax agency. If not, compliance will decrease when taxpayers determine that "get tough" tax collection promises are not carried out. When compliance declines, less tax revenue is collected by the Commission. This means less revenue is available for state programs.

### **RECOMMENDATION**

THE TAX COMMISSION COLLECTIONS DIVISION SHOULD TAKE NECESSARY STEPS TO COLLECT BACK TAXES OWED TO THE STATE. RETAIL BUSINESSES REFUSING TO PAY SHOULD HAVE THEIR SALES TAX LICENSE REVOKED AND/OR FACE CRIMINAL CHARGES, IF WARRANTED.

### **Audits of Taxpayers**

An examination of the Tax Commission's system for auditing taxpayers revealed problems which must be resolved to maximize use of audit personnel and ensure productive audits are conducted.

### **Audit Selection Program**

The Tax Commission has not implemented a program to select audits for individual income, domestic corporate income, or sales and use tax (excluding one special project). These taxes account for approximately 80% of the state's general fund revenue. There is no system to ensure potentially productive audits are selected from these taxes. Since there is no selection process for the major taxes, the Council asked district auditors and state office personnel how audits are selected. These officials stated that, primarily, individual auditors decide who to audit. Further, staff told the Council that an auditor generally

gets his/her leads from "birddogging" (observing the audit territory), news sources, and other audits.

The Tax Commission does have an Audit Selection Group, consisting of three experienced auditors, which was established to select audits with high potential for revenue production. However, members of the Audit Selection Group told the Council that the review of returns is limited to miscellaneous, motor fuel, and foreign (out-of-state) corporate income tax. There is no evidence of a selection process for other taxes.

The Council further analyzed a sample of 27 motor fuel audits conducted in FY 83-84. The analysis indicates that audits with low revenue production have been selected. Of the 25 reviewed, 16 resulted in 'no change' in the taxpayers' liability, seven averaged \$680 in audit assessments, and four yielded refunds of \$10,000 to the taxpayers.

To help ensure compliance with the state tax laws, all types of taxes must be reviewed by the Audit Selection Group or by a computer program. Without an audit selection program for all taxes, there is a greater risk that tax discrepancies may go undetected. There is no system to identify for possible audit, major fluctuations in sales tax or unexplained discrepancies. This may result in loss of revenue to the state.

### **Field Audit Coverage**

An examination of the Commission's audit coverage revealed two problems. First, the Commission does not have a plan or method to assign auditors to audits with the greatest probability of yielding large assessments. Such a plan should maximize the ratio of tax dollars assessed to dollars spent auditing, while providing a minimum level of coverage for all taxes.

Second, the number of audits conducted of the major taxes (sales and use, individual, and corporate income) is

low. As indicated in Table 1, the chance of a sales tax audit which generates the largest assessment was less than two-thirds of 1% in FY 84-85. Miscellaneous audits, such as admissions and bingo taxes, which generate an average of \$900 per audit, have a higher rate of audit coverage. Proportionally, the Commission allocated more audit resources to miscellaneous taxes than sales tax, which on average produced 26 times the assessment of miscellaneous tax audits.

**TABLE 1**  
**AUDIT ASSESSMENTS AND COVERAGE BY TYPE OF TAX**  
**FY 83-84 AND FY 84-85**

<u>Tax</u>	<u>Average Assessment</u>	<u>Approximate<sup>1</sup> No. of Taxpayers</u>	<u>No. of Audits Conducted in FY 84-85 (% of Taxpayers Audited)</u>	<u>No. of Audits Conducted in FY 83-84 (% of Taxpayers Audited)</u>
Sales and Use	\$23,400	80,500	498 (0.6)	744 (0.9)
Corporate Income <sup>2</sup>	14,400 <sup>3</sup>	62,000	275 (0.4)	576 (0.9)
Individual Income <sup>4</sup>	4,500	1,473,000	280 (.02)	440 (.03)
Miscellaneous <sup>4</sup>	900	2,200	62 (2.8)	272 (12.4)
Motor Fuel	1,200 <sup>5</sup>	32,200	142 (0.4)	504 (1.6)
Estate and Gift	3,800 <sup>5</sup>	3,800	280 (7.4)	57 (1.5) <sup>5</sup>

<sup>1</sup> Average of total number of taxpayers in FY 83-84 and FY 84-85.

<sup>2</sup> Includes domestic and foreign audits.

<sup>3</sup> Includes only audits conducted in FY 84-85.

<sup>4</sup> Includes admissions, documentary, bingo, beer and wine, business license, electric power, and soft drink taxes.

<sup>5</sup> Includes audits from February 1984 to June 1984.

Source: Tax Commission audit records.

Since the major taxes averaged more in assessments than other taxes, there should be an increase in total assessments and collections if more of these audits are conducted and the number of audits in other taxes is reduced. According to a nationally recognized tax expert, coverage in sales and use tax should be at least 2%. Other states strive for higher coverage.

Increasing audit coverage is important because it has a direct impact on overall audit assessments. Additional coverage would also promote taxpayer compliance by increasing the probability that a taxpayer will be audited.

The Commission has not analyzed data on field audit performance according to the type of tax audited. Without analysis of such information, there is less assurance that audit resources are allocated effectively. Also, the Commission cannot ensure that an acceptable level of compliance is maintained for all taxes.

#### **Use of Field Auditors' Time**

South Carolina Tax Commission auditors spent 51% of their time auditing from January 1985 to March 1986. According to Tax Commission documents, 38% of the time available for auditing was spent on training, special assignments, meetings, and/or other nonaudit activities. Additional nonaudit activities include travel, public assistance and audit selection. The remaining auditors' time was charged to leave and holidays. Auditors have been withdrawn from audits to help in the state and district offices as needed.

Since audit time has a direct impact on the total amount of tax assessments, less audit time reduces overall assessments. Therefore, each audit hour spent on another activity will result in loss of revenue to the state. Also, reduced likelihood of an audit lessens the incentive for taxpayers to comply with state tax laws.

If each of the Commission's auditors takes 12 holidays, 30 annual and sick leave days, five days for training, and 15 days for nonaudit activities yearly, auditors would still have at least 75% of their time available to perform audits. Tennessee's review of its state revenue agency suggests that auditors should spend 80% of their time auditing. An increase in direct audit time from 51% to 75% could result in a yearly increase of \$11 million in tax assessments.

Tax Commission management has not developed standards pertaining to the amount of time auditors should spend auditing. Neither has management ensured that auditors spend a minimum specified amount of time auditing taxpayers.

Further, agency management has not analyzed audit time variations among the tax district offices.

### **Comparison of District Audit Productivity**

The South Carolina Tax Commission has not adequately compared audit assessments within or among the tax district offices. A comparison and analysis is needed to determine why some districts are more productive than others.

The Audit Council reviewed assessment data from five tax district offices and found that the average monthly assessment per auditor ranged from \$10,000 to \$35,000 in one district to \$0 to \$588,000 in another. Average monthly assessments for the districts and auditors sampled were as follows:

**TABLE 2**  
**ANALYSIS OF TAX AUDIT ASSESSMENTS**  
**JANUARY 1985 TO MARCH 1986**

<u>District</u>	<u>Average Monthly Assessment By District</u>	<u>Average Monthly Assessment<sup>1</sup> By Auditor</u>
Charleston	\$ 238,000	\$24,000
Columbia	1,198,000	60,000
Florence	122,000	15,000
Greenville	154,000	12,000
Spartanburg	223,000	20,000

<sup>1</sup>The average monthly assessment by auditor includes only those auditors who worked in the same tax district from January 1985 to March 1986.

Source: Tax Commission audit records.

The Council examined, in detail, audit assessments in the Greenville and Spartanburg districts. From January 1985 to March 1986, Spartanburg had assessments of \$3.3 million, compared to Greenville's \$2.3 million, although Spartanburg has four fewer auditors than Greenville. Tax Commission officials were unable to explain why Spartanburg was able to

assess 43% more revenue with at least two less auditors than Greenville.

Good managerial practice would require examining audit productivity to determine why some individual auditors and districts are more productive than others. By not comparing district audit assessments, the Commission cannot account for assessment differences. By comparing and analyzing district audit productivity, information could be shared which could result in more revenue collections for the state.

Without proper analysis of audit assessments, the Commission cannot effectively evaluate district audit functions, determine if audit resources have been allocated properly, and make recommendations for change.

#### **RECOMMENDATIONS**

THE TAX COMMISSION SHOULD DEVELOP AND IMPLEMENT AN AUDIT SELECTION PROGRAM WHICH ENCOMPASSES ALL TYPES OF TAXES.

THE TAX COMMISSION SHOULD ANALYZE AUDIT ASSESSMENT DATA ACCORDING TO THE TYPE OF TAX AUDITED. THE COMMISSION SHOULD THEN TAKE PROMPT ACTION TO DEVELOP AND IMPLEMENT A PLAN WHICH ALLOCATES THE GREATEST PROPORTION OF AUDITORS TO TAX AREAS LIKELY TO BE THE MOST PRODUCTIVE. SUCH A PLAN SHOULD PROMOTE A MINIMUM LEVEL OF COMPLIANCE FOR ALL TAXES.

THE TAX COMMISSION SHOULD ESTABLISH AUDIT TIME STANDARDS TO ENSURE THAT AUDITORS DEVOTE ADEQUATE TIME TO PERFORMING AUDITS.



THE TAX COMMISSION SHOULD ANALYZE AUDIT ASSESSMENT DATA TO DETERMINE THE REASON(S) FOR VARIATIONS AMONG OR WITHIN THE TAX DISTRICTS, AND TAKE ACTION TO INCREASE AUDIT ASSESSMENTS.

### **Waiver of Tax Penalties**

The Commission's application of penalties to taxpayers filing late returns, taking unauthorized deductions, and evading taxes was examined. Commission internal accounting controls pertaining to penalty waivers have been inadequate. Also, the Commission has been inconsistent in deciding when reasonable cause exists to waive penalties. Because an audit trail of penalties waived was not maintained by the Commission, an examination of all waivers could not be conducted. A review of taxpayer requests for waivers was conducted when the Audit Council examined audit and delinquency records and found a request for waivers. The following problems were found.

### **Inadequate Controls**

There have been no controls over the "write offs" of penalties. In several tax divisions, requests for waivers can be phoned in and approved by tax officials without management oversight or approval. In one division, agency officials stated that clerical employees could waive penalties assessed a taxpayer. The Commission cannot provide information concerning all taxpayers requesting a waiver. Also, there is no consistent Commission policy for use by all departments outlining conditions for application of penalties.

### **No Guidelines for Sales Tax**

The Commission has not established guidelines for waiver of delinquent sales and use tax penalties. For sales

tax, one person can waive late filing penalties for "good cause." "Good cause" has not been defined by the Commission for sales tax.

### **Inconsistent Waivers**

Although other taxes have guidelines for waivers, penalties and interest resulting from audits or delinquent returns have been dismissed for inadequate reasons. Also, some penalties have been waived after Commission employees stated that the taxpayer's reason did not justify a waiver. Further, Commission employees granted some waivers before the taxpayer made a request. As previously stated, the extent of waivers approved could not be determined since adequate records to create an audit trail of these transactions were not maintained.

The Council examined 25 "Requests for Waiver" and found that all had been approved. The following are examples of waivers:

- A company was audited and found to owe \$228,214 in tax, penalties and interest. The Commission, upon satisfactory payment of the tax (\$150,000), agreed to waive \$78,214 in penalties and interest. [Emphasis Added] The Council found five cases involving partial or total waivers of interest.
- A business requested a waiver of penalty and interest due to a misunderstanding of the law and the death of the office manager. The Commission staff waived penalties and interest.
- One company requested a waiver of \$10,694 in penalties based on its previous record of filing correct returns. Although Commission staff stated that this reason did not justify a waiver, the company was allowed to pay only \$5,133 in penalties, less than one half of the original assessment.
- In another instance, a Commission supervisor stated that a request did not warrant a waiver. The taxpayer then asked another Commission employee for a waiver. The second employee authorized the taxpayer to pay only \$35 (a license tax penalty) of the \$1,086 penalty assessment.

- The Commission staff repeatedly reduced or abated approximately \$8,000 in penalties against a company after the company claimed negligence by its bookkeeper for at least four quarters (see p. 35).
- A clerical employee waived \$200 in penalties and a possible \$3,000 in specific penalties for filing delinquent withholding returns. The Council could find no documentation as to why these penalties were waived.
- One business was assessed \$864 in penalties for filing a late sales tax return. The penalties were waived after the taxpayer said that he did not know that sales tax returns were to be filed monthly.
- Another business requested waiver of \$158 late filing penalty, in part, because he did not have the forms to file the return. The penalty was waived.
- A taxpayer requested a waiver of a \$4,600 late filing penalty stating the return had been mailed. Although the Commission had not received the return approximately one month after the due date, the penalty was waived.

According to Commission officials, better procedures and documentation pertaining to penalty waivers are needed. Additionally, an official stated that waivers need to be more closely monitored. South Carolina Code of Laws §12-54-160 states that the Commission, unless prohibited by statute, may waive, dismiss or reduce penalties. Interest cannot be waived.

Good internal controls require that transactions be properly authorized and recorded to permit accountability. An internal study, conducted by the Commission in 1985, recommended a system to determine which accounts had penalties waived and a system to monitor this process.

The Internal Revenue Service does not abate interest charges other than those assessed because of departmental error. Also, the state revenue agency in Georgia cannot waive interest for reasonable cause. Additionally, tax officials in North Carolina stated that interest is not waived for reasonable cause.

## **Conclusion**

The lack of management oversight in authorizing penalty waivers has increased the potential for unwarranted "write-offs." In addition, when the Commission fails to penalize taxpayers for not complying with the state tax laws, there is less incentive for taxpayers to comply. Also, without enforcement of guidelines outlining when penalties can be waived, there is no assurance that waivers are approved consistently.

After a review by the Council, the Tax Commission implemented new procedures pertaining to penalty waivers. Management must now be committed to ensuring that if penalties are waived, they are done so for good cause.

## **RECOMMENDATION**

THE TAX COMMISSION SHOULD CLOSELY  
MONITOR THE APPLICATION OF PENALTIES  
ASSESSED TAXPAYERS. PENALTIES SHOULD BE  
WAIVED ONLY FOR "GOOD CAUSE" AS DEFINED  
BY THE COMMISSION.

## **Delinquent Field Collections**

The Tax Commission's Collections Department is responsible for collecting delinquent taxes owed to the State. Approximately 80 revenue offices are located throughout the State to enforce collection. Nineteen revenue officers are responsible solely for warrant collection and enforcement. These officers have legal authority to garnish wages, seize property and bank accounts, close businesses, and take other enforcement actions necessary to enforce payment of tax debts. The number of delinquent tax debts and warrants (issued to allow seizure of property for nonpayment of tax liabilities) has been increasing. For example, sales tax delinquencies have increased from approximately 5,000 monthly to 7,000 (40%) in three years.

The Commission has implemented new procedures to help streamline delinquent tax collection. In January 1986, sales tax delinquencies were forwarded to the telephone collections department for telephone contact prior to enforcement action. The Commission proposes phasing in telephone contact for all taxes if sales tax delinquent collections are improved by reminding taxpayers, by telephone, of the delinquency. The effectiveness of the "phone power" section could not be adequately assessed by the Audit Council due to its short duration of operation. However, preliminary results appear to be favorable.

#### **Warrants Issued in Error**

The Tax Commission has been issuing warrants to seize property against taxpayers, when the taxpayers have no tax liability. Between July 1982 and March 1986, over 25,000 (9%) of the 279,000 warrants issued were improperly filed against taxpayers due to Tax Commission errors.

When a warrant is issued, a lien is recorded in the courthouse where the taxpayer (or taxpayer's business) is located. The warrant creates a lien against all assets and property owned by the taxpayer and allows the Commission to seize the taxpayer's property. Further, the Commission must pay a \$2 recording fee to the courthouse. This means the agency spent over \$50,000 to file unnecessary warrants. Also, warrants issued in error have caused taxpayers to have a bad credit rating due to no fault of the taxpayer.

For example, in 1984, one taxpayer paid his liability as required. The Commission erroneously issued a warrant for nonpayment, causing a tax lien to be filed in the county courthouse. The taxpayer was subsequently denied a loan because of his public record of failure to pay state taxes.

In another case, a taxpayer paid a sales tax liability on January 14, 1986. On March 4, 1986, a warrant was issued, in error, for nonpayment of that liability. The warrant officer received the warrant and notified the

taxpayer of the immediate need to pay the debt, only to learn that it had been paid six weeks earlier.

By not spending time processing warrants issued when no tax is due, warrant officers and office staff could be more productive. Also, filing warrants against taxpayers with no liability damages the Commission's reputation as an effective tax administrator, and erodes taxpayer confidence in the Commission's ability to enforce tax laws.

Erroneously filed warrants have been a source of complaints by taxpayers. In a May 1984 memo to the Commission's Executive Director, a Tax Commissioner stated:

During recent weeks I have received numerous complaints from taxpayers regarding the issuance of warrants for distraint. On several occasions, the warrants were issued in error causing embarrassment to the Commission and to the taxpayer.

The Commissioner requested an analysis to determine how to limit the number of erroneous warrants being issued. However, this problem has increased.

There are several reasons why warrants are generated when the tax liability has been paid. First, the taxpayers' returns are not processed in a timely manner (see p. 81). The taxpayer could pay the liability, but the payment may not be posted on the computer for over 20 days. Secondly, if the payment is on the computer, it may not be matched against the warrants being issued to ensure only unpaid accounts are issued a warrant. Additionally, certain returns, such as those showing no tax due, have low processing priority. Agency officials stated returns can take over three weeks to process. Therefore, a warrant can be issued after a taxpayer has properly filed a return.

#### RECOMMENDATION

THE TAX COMMISSION MUST TAKE IMMEDIATE  
MEASURES TO ENSURE THAT WARRANTS ARE NOT

FILED AGAINST TAXPAYERS WITH NO TAX  
LIABILITY.

**Warrant Collection Priority Order**

Priority order for warrant collection is not established by the dollar amounts of the tax owed, or other necessary criteria. Instead, priority is established by the type of delinquent tax. That is, sales tax has first priority followed by withholding and other types of delinquent taxes. This type system does not provide for priority based on dollar amount of the warrant.

For example, Tax Commission records indicate that one revenue officer drove 29 miles, and collected approximately \$4,700 on four warrants (ranging from \$51 to \$3,962). The next day, the same officer drove 61 miles to attempt collections on four warrants, none over \$15.60. The officer collected \$50.70 that day. If placed in priority by dollar amount, the larger delinquencies would be pursued first, bringing in more tax revenue and increasing interest income to the state.

With over 31,000 outstanding warrants, for over \$22 million in unpaid taxes, a system to pursue the high dollar amount first is needed. A system to sort warrants by priority and by geographic location would assist collectors across the state processing warrants more efficiently, and would allow for better use of Tax Commission resources.

**RECOMMENDATION**

THE TAX COMMISSION SHOULD ESTABLISH A  
SYSTEM TO PROCESS WARRANTS BASED ON  
CRITERIA SUCH AS THE DOLLAR AMOUNT OF  
THE DELINQUENCY.

**Criminal Investigations**

The Criminal Intelligence Division (CID) has the responsibility of investigating instances of suspected tax

fraud. The Division obtains leads from three sources - referrals from other divisions within the Tax Commission, tips from citizens, and information that arises from CID special projects. The Council reviewed CID's methods for deciding which cases to recommend for prosecution, and its methods for following up on cases it had investigated. The problems that were found are discussed below.

### **System for Prosecuting Tax Evaders**

The Tax Commission has no system or formal policy of referring questioned cases to prosecutors for review of the Tax Commission's decision not to seek prosecution. After the Criminal Intelligence Division completes its investigation of a suspected tax evasion case, the Division Director, in consultation with the CID investigator, makes a recommendation about whether to refer a case for outside review. All recommendations are taken before the Commissioners who are briefed about the cases, and the Commissioners decide whether or not to accept the recommendations of the CID Director. In general, only those cases that the Tax Commission recommends for prosecution are referred to the Attorney General's Office or local Solicitor's Office for evaluation. The Attorney General's Office, or solicitor, makes the final decision about whether to try a case that has been forwarded by the Tax Commission.

The Council reviewed all investigations which were closed by CID between July 1983 and April 1986. Of the 134 cases reviewed, indictments, convictions or guilty pleas were obtained in 23 cases involving approximately 30 individuals.

The following excerpts from CID files describe cases the Tax Commission decided did not warrant criminal prosecution.

1. An attorney had not filed South Carolina income tax returns for the years 1975 through 1982. The taxpayer's affidavit stated:



I have not filed...I knew that I was required to file...I just procrastinated and tended to my clients work and just simply didn't tend to my personal business...

The closing report stated, "It is felt the case would lack sufficient prosecutorial potential based on the facts and circumstances."

2. A CPA had not filed his individual income tax returns for the years 1976, 1977, 1978, 1980, and 1981. According to CID, facts of the case do not demonstrate the requisite intent to evade the tax laws, and the tax due would be a nominal amount for a criminal case.
3. An architect had failed to file individual income tax returns for the years 1982 and 1983. He also was not filing withholding reports or paying withholding tax on his employees. He stated that he was delinquent in filing his withholding tax reports because "...it was necessary to use the withholding tax in my business." He had previously been delinquent for the years 1979, 1980, and 1981. The closing report stated, "It was felt there was not enough evidence to warrant prosecution."
4. A large corporation was audited for the period January 1979 through December 1980, and found not to be paying use tax owed the state. As a result of the audit, the company paid the state, without protest, over \$10,000 in use tax. Records indicate that the taxpayer was advised to start accruing use tax and remit it to the state. The same company was audited again for the period 1982 through 1984, and was found still not to be paying use tax of approximately \$20,000. The penalty section of the audit stated "5% penalty applicable - negligence" and "recommend penalty be held, t/p [taxpayer] aware of statute." The Tax Commission did not refer the case for prosecution in part because there were technical issues that might create problems for a possible prosecution.
5. One case was referred to CID for understatement of taxable income, unreported sales, and failure to file a return. The owner of a business has made the statement, "If audited and a liability is due, I would change license to another person's name, and open up another location down the street and continue to operate, which I did under the name of X." The business was closed by the Commission, with unpaid warrants in excess of \$3,900, and reopened under the name of X. The Commission did not recommend prosecution in part because of the difficulty in

getting information necessary to prove or disprove sales.

Other similar cases have been referred to CID that did not result in criminal charges being sought.

In order to successfully encourage compliance with the tax laws of this state, the Tax Commission must take strong action in those cases where the evidence indicates that a criminal violation has occurred. Public confidence in the fairness of the tax system could be eroded if the public were aware that cases like those described above were not brought before a Grand Jury or prosecutor.

According to officials at the Tax Commission, there are many reasons why indictments have not been sought in certain cases. One of the major reasons is that the law requires proof of specific intent to evade the tax laws. For example, in order for criminal fraud to be proved, the taxpayer must not be merely negligent but must have intended to commit fraud. This is a heavy burden of proof for the Tax Commission, complicated by the fact that evidence in a tax case is almost always circumstantial. Other reasons for not seeking an indictment include low dollar amount, inability to pay, nonfiling for only one year, and insufficient evidence of intent. These reasons are not necessarily those cited in cases illustrating these findings.

There is no requirement for prosecutors to review any cases other than those in which the Tax Commission recommends indictments, nor are there requirements for the Tax Commission to forward all cases to outside prosecutors. A system of referring all cases in which there is a substantial appearance of a criminal act would allow experienced prosecutors to determine whether a case had prosecutorial potential. Such a system would allow prosecutors to consider the potential defenses (such as negligence) that might be raised by the defendant, to evaluate whether the defenses would be likely to convince a

jury, and to determine what kind of counter-arguments could be used by the state.

### **Follow-up of Investigations**

The Tax Commission has an inadequate system for following up on cases referred from CID to Field Services for resolution. The Director of CID has requested that Field Services inform him of action taken to close cases that had been investigated by CID. However, neither CID nor Field Services follows up to ensure that taxpayers who have been investigated by CID continue to file returns in the years after the close of the investigation, or that taxpayers owing money pay.

The following examples from Tax Commission files are illustrative:

1. As described on page 29, an architect was investigated by CID for failure to file his returns for 1981, 1982 and 1983. He had previously been delinquent for the years 1979 and 1980. As a consequence of the investigation, the taxpayer filed his returns through 1983. The closing report stated, "It was felt there was not enough evidence to warrant prosecution." A search of the Tax Commission computer records revealed that this individual has subsequently not filed income tax returns for the years 1984 and 1985.
2. As described on page 29, a certified public accountant was investigated for failure to file individual income tax returns for the years 1976, 1977, 1978, 1980, and 1981. CID decided not to pursue prosecution. The taxpayer has since paid the amount due for the years under investigation. However, a search of the Tax Commission computerized files revealed that this individual has not filed returns for 1983, 1984 or 1985.
3. As described on page 29, according to Commission records, the owner of a business told the Commission that if audited, he would change his business license to another name to avoid tax liabilities. When the business was closed by the Tax Commission, the Tax Commission declared uncollectible over \$3,900 in outstanding warrants. When the same business opened under another name, the owner posted a \$2,000 surety bond prior to being granted a license. The business accumulated outstanding warrants of \$377 before

closing. Computer records indicate that this liability was paid in June 1986 after being declared uncollectible by the Tax Commission. There is no evidence that the Tax Commission sought to collect on the surety bond.

These and other cases examined indicate the need for follow-up on CID investigations.

No official or division has been assigned the responsibility to ensure that these individuals' returns were filed. Both CID and Field Services indicated they do not have the resources to determine whether a taxpayer continues to abide by the tax laws after a CID investigation is completed. In addition, the computer has not been programmed to identify whether there is a gap in the taxpayer's filing history.

Instances such as those described above indicate that the Tax Commission has not taken follow-up action as warranted by the facts of the particular cases. If CID was aware of a renewed pattern of nonfiling after the close of an investigation, it might cause the Division to reevaluate its initial determination that there was insufficient evidence to seek criminal charges.

### **Referrals to Licensing Boards**

The Tax Commission interprets confidentiality laws as prohibiting them from forwarding to licensing boards names of attorneys and accountants who fail to file their tax returns as required by law. However, if a conviction is obtained, this information would be public and not protected by the confidentiality statutes. Council's review of CID files found cases involving attorneys and accountants not filing their South Carolina individual income tax returns for two or more years. They include the following examples which were not referred to licensing boards:

1. An attorney had not filed for six years. Tax Commission computer records indicate as of June 30, 1986, he owed over \$700 in delinquent taxes, penalties and interest. (He has since been indefinitely

suspended by the state Supreme Court for other improprieties, including financial transactions involving clients' funds.) This case was not forwarded to the Board of Commissioners on Grievances and Discipline of the South Carolina Supreme Court.

2. As described on page 29, a certified public accountant had not filed his returns for the years 1976, 1977, 1978, 1980, and 1981. He has since paid the amount due, but has not filed for 1983, 1984 or 1985. This case was not forwarded to the Board of Accountancy.

These and other similar cases suggest the need for a policy for referring attorneys and accountants to the appropriate licensing boards for possible disciplinary action.

Sections 12-7-1680 and 12-35-1530 of the South Carolina Code of Laws govern secrecy of tax reports and returns. These sections provide, in essence, that except in accordance with judicial order or as otherwise provided by law:

...it shall be unlawful for members of the [Tax] Commission...to divulge...the amount of income...the amount of the sales or gross receipts or any particulars set forth or disclosed in any report or return required under this chapter [governing income, license, sales and use taxes].

Section 12-15-1615 parallels the other two provisions and relates to estate and gift tax returns. Although it could be argued that these provisions apply only to substantive information contained in the report or return, the Tax Commission interprets them as referring to the fact of nonfiling, even if no substantive information about income or sales is revealed.

Another agency refers cases to licensing boards even if no conviction is involved. For example, if DHEC has sufficient evidence that nurses, dentists, veterinarians, physicians, or pharmacists are violating controlled substance laws, DHEC forwards their names to the appropriate licensing boards even if there has been no conviction.

When cases are not referred, licensing boards cannot determine if disciplinary action is warranted. Language of the South Carolina Code of Professional Responsibility for Lawyers suggests that the Board of Grievances and Discipline might be interested in the fact of nonfiling by attorneys.<sup>1</sup> Forwarding cases could help increase tax compliance if licensed attorneys and accountants knew they might risk disciplinary action by their licensing boards.

### RECOMMENDATIONS

THE TAX COMMISSION SHOULD DEVELOP A FORMAL POLICY OF REFERRING CASES WHICH HAVE THE SUBSTANTIAL APPEARANCE OF CRIMINAL ACTION TO THE APPROPRIATE PROSECUTORIAL BODY FOR REVIEW.

THE TAX COMMISSION SHOULD DEVELOP A SYSTEM TO ENSURE THAT CASES REFERRED FROM CID TO FIELD SERVICES RECEIVE THE NECESSARY FOLLOW-UP ACTION FROM THE APPROPRIATE DIVISION.

THE TAX COMMISSION SHOULD SEEK CLARIFICATION OF THE SECRECY STATUTE TO

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<sup>1</sup>The South Carolina Supreme Court Rule on Disciplinary Procedure defines misconduct as "acts or omissions...which violate...the Code of Professional Responsibility...whether or not the act or omission occurred in the course of the attorney-client relationship." The ethical considerations of the Code state that a lawyer "should refrain from all illegal and morally reprehensible conduct. Because of his position in society, even minor violations of law by a lawyer may tend to lessen public confidence in the legal profession." Disciplinary Rule 1-102 states that a lawyer shall not "engage in illegal conduct involving moral turpitude" and "in conduct involving dishonesty, fraud, deceit, or misrepresentation."

DETERMINE IF THE FACT OF PERSISTENT  
NONFILING BY ATTORNEYS AND ACCOUNTANTS  
IS COVERED BY THE STATUTE. IF NOT, AND  
A WARRANT HAS BEEN ISSUED, THIS  
INFORMATION SHOULD BE REFERRED TO THE  
APPROPRIATE LICENSING OR DISCIPLINARY  
BOARDS FOR POSSIBLE DISCIPLINARY ACTION.

IF SUCH INFORMATION IS PROTECTED BY THE  
EXISTING STATUTE, THE GENERAL ASSEMBLY  
SHOULD CONSIDER AMENDING THE STATUTE TO  
ALLOW DISCLOSURE OF THE NAMES OF  
PERSISTENT NONFILERS TO THE APPROPRIATE  
LICENSING OR DISCIPLINARY BOARDS.

#### **Personal Business With Company While Waiving Penalties**

The Tax Commission has allowed employees authorizing penalty waivers to do personal business with these companies. This has resulted in possible ethics violations and the appearance of a conflict of interest which were not reported to outside authorities for investigation.

Between October 1981 and March 1982, a district supervisor approved waiver and reduction of tax penalties of at least \$8,000 against an automobile dealership. This company continued to not pay employee withholding taxes. In October 1982, this supervisor received approximately \$700 in services for only \$100 from this company. (The services included auto body work and a paint job.) Agency documents indicate that the manager of the business instructed a worker that this vehicle "belonged to an employee of the Tax Commission and to give him a good estimate." Further, another dealership employee was told to provide these services "at cost, minimal cost, or no cost."

Approximately one day before this repair work was done, a high-level tax official purchased a car from this company. A second official bought two cars from the dealership

approximately four and eight months prior to the repair work. Both officials, located in Columbia, traveled over 100 miles to do business with this company. An agency internal investigation found that no wrongdoing occurred in these car purchases. However, the employee receiving the repair services at a reduced price was reprimanded for using poor judgment, while no action was taken against the other two employees. (The other employees were found by the Commission to have paid market value for their cars).

When Tax Commission officials conduct business with companies they are waiving tax penalties against, the appearance of impropriety exists. While the Tax Commission found that one employee received a "possible gift" after allowing the company to pay less money than assessed, the State Ethics Commission was not notified and an outside investigation was not conducted.

Section 8-13-10 of the South Carolina Code of Laws states:

The General Assembly hereby finds and declares that public office and public employment is a public trust and any effort to realize personal gain through official conduct is a violation of that trust. [Emphasis Added]

Also, §8-13-410 states, "No public employee shall use his official position or office to obtain financial gain for himself." Section 8-13-20 defines a public employee as "any person employed by the State or a county, municipality or other political subdivision thereof..."

Furthermore, §16-9-210 prohibits businesses from influencing public employees. In addition, §8-13-120 requires the State Ethics Commission to investigate allegations against any public official or employee with the exception of the General Assembly.

Accepting, as well as the appearance of accepting, gifts to influence action on tax related matters jeopardizes the credibility of the Tax Commission and could effect



compliance with state tax laws. Further, when administrative tax officials do business with companies they are auditing or granting favors to, they fail to set a proper leadership example for other employees to follow.

At the time this situation occurred, the Tax Commission had not adopted an Employee Code of Conduct outlining appropriate behavior when authorizing penalty waivers or conducting audits. The Commission proposed and passed a code during the Council's review.

### **RECOMMENDATIONS**

THE TAX COMMISSION SHOULD ENSURE  
POSSIBLE ETHICS VIOLATIONS ARE REPORTED  
TO THE ETHICS COMMISSION. ANY ALLEGED  
VIOLATION OF ETHICS LAWS OR OTHER  
STATUTES SHOULD BE REFERRED TO THE  
APPROPRIATE AUTHORITIES.

THE ATTORNEY GENERAL'S OFFICE OR  
SOLICITOR'S OFFICE SHOULD INVESTIGATE  
THE CASE TO DETERMINE IF IMPROPRIETY  
EXISTS.

### **Enforcement of Private Car Line and Airline Taxes**

The Tax Commission has not consistently enforced laws regarding the assessment, billing and collection of property taxes on private car lines (railroad cars) and airlines. (This is the only property tax collected by the state.) As of January 1986, approximately \$300,000 in back taxes, penalties and interest were owed by private car lines and airlines for calendar years 1983, 1984 and 1985. The Commission has not assessed penalties on all private car lines which did not file or filed late returns. In addition, interest has not been charged to all late payers. Further, the Tax Commission has not adequately pursued

collection on private car lines and airlines which do not pay their taxes.

For example, one South Carolina-based airline which owes more than \$200,000 in back taxes, penalties and interest has not paid its aircraft property tax since 1980. However, the Tax Commission did not initiate legal action to collect the taxes until February 1986, when reviewed by the Audit Council.

Section 12-54-40 of the South Carolina Code of Laws, 1976, as amended (effective September 1985), requires the assessment of a penalty of 5% of the amount of the tax per month or fraction thereof, not to exceed 25% of the tax. Section 12-54-20 requires that interest be charged on all taxes paid after the payment deadline. Further, §12-54-60 requires the Commission to estimate and assess the taxes, fees, penalties, and interest due the state from any person who does not file a return as required by law.

According to Tax Commission officials, estimated assessments are not charged penalty and interest because the estimates are usually high. However, one car line, with an estimated assessment of \$23,000, actually owed over \$74,000 when an assessment was calculated on a late filed return. (The penalty would have been over \$3,500 for late filing.) Officials also stated that if a private car line pays after the deadline, and pays only the tax, they will not reassess for unpaid penalty and interest. Tax Commission officials further stated that the law prior to 1985 did not allow them to issue a warrant to collect the back taxes. However, the Tax Commission took no other action to collect the taxes, such as filing suit for recovery or turning the matter over for collection. During the Council's review, the Tax Commission began corrective action in this area.

#### RECOMMENDATIONS

THE TAX COMMISSION SHOULD FILE WARRANTS  
FOR PRIVATE CAR LINE TAXES DELINQUENT

SINCE DECEMBER 1985. THE COMMISSION SHOULD FILE CIVIL SUITS FOR RECOVERY OR TURN OVER FOR COLLECTION ALL DELINQUENT TAXES FROM PRIOR YEARS.

THE TAX COMMISSION SHOULD ASSESS AND COLLECT PENALTIES AND INTEREST FROM ALL PRIVATE CAR LINES AND AIRLINES WHICH DO NOT FILE RETURNS OR PAY TAXES AS REQUIRED BY LAW. IF THEY ARE LOCATED OUT-OF-STATE, DELINQUENT ACCOUNTS SHOULD BE SENT TO A COLLECTION AGENCY.

## **CHAPTER II**

### **ADMINISTRATION OF TAX LAWS**

The Office Services Division is responsible for the administration of tax laws as related to corporate and individual income taxes, sales tax, license taxes, estate and gift taxes, and other taxes administered by the Commission. The Division is responsible for ensuring taxpayers file tax returns as required, processing tax returns, issuing refunds, and maintaining files on taxpayers.

When taxpayers do not file returns, Office Services is responsible for mailing delinquent notices. The Division is required to penalize taxpayers filing late or underpaying their liabilities. They are required by law to assess an estimated tax liability when delinquent notices are not answered. Then, if assessments are not paid, the Division is responsible for filing a warrant for distraint, allowing for seizure of property.

An examination of Office Services revealed that certain laws pertaining to state taxes were not properly administered by the Commission. This has allowed taxpayers to avoid paying taxes due to the state and to pay some taxes late without penalty. This chapter concentrates on administration of the major taxes - corporate and individual income, withholding taxes, and sales and use.

#### **Administration of Sales and Use Tax Laws**

The Sales and Use Tax Department is responsible for registering businesses and ensuring a sales or use tax return is filed as required. As of December 1985, over 80,000 businesses were required to file a sales or use tax return; most were required to file monthly. Those with a tax liability of less than \$100 per month are allowed to file quarterly. In FY 84-85, sales taxes accounted for over \$800 million of the state's revenue. Large retailers are

required to pay approximately one-half of their monthly liability in advance. The Council reviewed the Tax Commission's system for ensuring returns are properly filed and paid and found the following problems.

#### **Enforcement of Sales Tax Prepayment Laws**

State law requires large retailers (over 280 in FY 85-86) to pay, in advance, approximately one-half of their monthly sales tax liabilities. State law normally requires the payment of sales tax collected during a month by the 20th day of the following month. However, retailers, who in the previous fiscal year had three straight months in which their sales tax liability exceeded \$20,000 per month, are required to prepay part of their sales tax on the 20th day of the month in which the sales tax is collected.<sup>2</sup> Although enacted in 1972, the Tax Commission did not begin enforcing the sales tax prepayment law until February 1986.

The Audit Council examined, in a random sample, 136 tax returns of companies required to prepay part of their monthly sales tax. Of these, 48 (35%) did not include a prepayment or included an inadequate prepayment.

#### **Penalties Due to Lack of Sales Tax Prepayment**

The Tax Commission has not penalized retailers for not prepaying part of their sales tax as required by law. The Audit Council estimates that the Tax Commission is required by state law to assess \$1.6 million in penalties against retailers which did not properly prepay their sales tax during the last three years. The Commission attempted to

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<sup>2</sup>South Carolina Code §12-35-580 requires such retailers to, "Pay at least 40% of the 'true estimated tax liability'...or 50% of the tax for the same month of the preceding year on or before the 20th day of the period covered."

penalize retailers for one month, but did so improperly (see p. 43).

Section 12-35-580 of the South Carolina Code of Laws requires the Tax Commission to assess a penalty of 5% of the amount of tax due if the failure to pay is for not more than one month. Section 12-35-580 states:

If any person fails to pay at least forty percent of the 'true estimated tax liability' if one is due, or fifty percent of the tax for the same month of the preceding year on or before the twentieth day of the period covered by the return, the difference between the amount paid and the amount due to have been paid shall be increased by five percent per month or fraction of a month from the date tax was originally due to the date of payment... [Emphasis Added]

Further, §12-54-40, enacted in 1985, makes it a crime for a company not to prepay sales tax.

In examining the records of companies required to make sales tax prepayments, the Audit Council found that companies which did not make prepayments, or made inadequate prepayments, did pay their sales tax, but paid part of it 30 days late each month. Thus, these companies should be assessed a 5% penalty on the amount of sales tax paid late. These penalties must be assessed a retailer who did not make a prepayment for each month that falls within the 36-month statute of limitations. The Attorney General's Office ruled, after the Council reviewed this area, that failure to prepay sales tax requires taxpayers to be assessed a 5% penalty for each month of inadequate payment. When penalties for late payment of taxes are not assessed, there is less incentive for taxpayers to comply with due dates. Thus, compliance will decrease when penalties are not assessed taxpayers negligent in complying with tax laws.

### **Interest From Prepayment of Sales Tax**

By not enforcing the prepay law, the state lost an estimated \$88,000 in interest in 1985. Also, \$265,000 in interest was lost from 1983 to 1985, due to large retailers not properly prepaying their sales tax as required by law.

While the prepay requirement became law in 1972, the Tax Commission did not, until February 1986, ensure that retailers who are required to prepay part of their sales tax do so. Yet, the Commission clearly prints the prepayment law on the sales tax return of the companies who meet the requirements.

By not requiring large retailers to prepay part of their sales tax, the Commission allowed approximately \$11 million in sales tax in 1985 to be paid 30 days late. This resulted in an estimated loss to the state of \$88,000 in interest income in 1985. An estimated \$32 million in sales tax was paid late from 1983 to 1985, resulting in an estimated loss to the state of \$265,000 in interest income.

### **Assessment of Nonprepaid Sales Tax**

In February 1986, the Tax Commission attempted to enforce the sales tax prepayment law. However, the Commission improperly assessed 45 companies \$139,000 in penalties for failing to prepay the required part of their June and/or July 1985 sales tax. The Tax Commission assessed penalties for one month at 25% when, by law, a 5% penalty was due for each month of inadequate payments. In addition, the Tax Commission attempted to force the companies to pay \$563,000 in taxes previously paid.

The companies penalized had paid their sales tax, but paid 30 days late, the amount which should have been prepaid. Section 12-54-580 requires the Tax Commission to "assess a penalty of 5% of the amount of the tax if the failure is for not more than a month." Thus, the Commission should have assessed only a 5% penalty. By assessing a 25%

penalty, the Tax Commission overassessed the 45 companies \$129,000.

### **Timely Payment Discount Taken on Sales Tax not Prepaid**

Retailers delinquently paying the prepay portion of their sales tax are allowed by law to take a "timely filing" discount. This has resulted in a loss to the state of approximately \$590,000 from timely sales tax payment discounts granted by the Commission during the period 1983-1985.

Section 12-35-1230 of the South Carolina Code of Laws allows sales taxpayers to take a 2% discount for the payment of their sales tax in a timely manner. Section 12-35-1230 states:

When a [sales tax] return...is filed and the taxes shown due thereon are paid in full on or before the final due date...the taxpayer shall be allowed a discount as follows:

...On taxes shown to be due by the return of one hundred dollars or more, two percent.

[Emphasis Added]

However, this discount cannot be granted if the tax is paid late. Section 12-35-1230 states:

In no case shall any discount be allowed if either the return or the tax thereon is received by the Commission after the date due... [Emphasis Added]

The Attorney General's Office, however, has ruled that these retailers are entitled to the timely filing discount on the prepay portion, although it is paid late.

By allowing those retailers who paid all or part of their required sales tax prepayment 30 days late each month to take a timely filer discount, an estimated \$590,000 in timely payment discounts were granted from 1983 to 1985 on "late" payments.



## **RECOMMENDATIONS**

THE TAX COMMISSION SHOULD ENSURE LARGE RETAILERS, REQUIRED TO PREPAY PART OF THEIR SALES TAX, PAY THEIR SALES TAX WHEN REQUIRED BY LAW.

THE TAX COMMISSION MUST PENALIZE RETAILERS WHO HAVE NOT COMPLIED WITH THE PREPAYMENT REQUIREMENTS OF STATE LAW.

THE TAX COMMISSION MUST RESCIND THE TAXES AND PENALTIES IMPROPERLY ASSESSED AGAINST RETAILERS FOR FAILING TO MAKE JUNE AND/OR JULY 1985 SALES TAX PREPAYMENT.

THE GENERAL ASSEMBLY SHOULD CONSIDER AMENDING THE TIMELY DISCOUNT LAW TO NO LONGER ALLOW THE "TIMELY FILING" DISCOUNT TO BE TAKEN WHEN PREPAYMENTS ARE PAID LATE.

## **Businesses Failing to File Returns**

The Tax Commission has not adequately assessed businesses for estimated tax liabilities when they do not file a return. According to Tax Commission records, as of November 22, 1985, over 2,000 businesses had not filed a sales or use tax return for at least one month between November 1984 and July 1985. As of October 1985, approximately 18.5% (15,000 of 80,000) of businesses were delinquent for at least one return due between September 1984 and September 1985.

The companies were not assessed estimated taxes as required by law. These businesses owed the state an estimated \$1.27 million in tax revenue (based on assessments issued other nonfilers). For example, one business had not

filed a May, June, or July return as of December 1985. State law would require an assessment of over \$10,000 for back taxes and penalties for this business based on previous tax liabilities. However, as of December 1985, the company was not assessed estimated taxes.

State law requires the Commission to bill a business not filing a return for estimated taxes due with a 50% penalty and interest applied. The Commission is required to bill the business if a return is not filed 20 days after notification of failure to file. These businesses were notified September 10, 1985 or earlier of their failure to file, and had not been assessed as of November 22, 1985.

According to Tax Commission officials, workloads at that time had increased too much to allow for timely manual assessments. The agency's computer is not programmed to issue an assessment of estimated taxes. When an assessment is issued, an employee has to manually research past tax liabilities, compute estimated taxes and penalties, issue paper work to initiate the assessment, and perform other manual work. An automated system would alleviate manual steps and expedite the process.

After the Council's review of this area, Commission officials stated that assessments were issued to all sales taxpayers not filing as required, and sent to the districts for collections.

#### **RECOMMENDATION**

THE TAX COMMISSION SHOULD ENSURE THAT  
BUSINESSES NOT FILING A RETURN ARE  
ASSESSED ESTIMATED TAX LIABILITIES AND  
PENALTIES IF THEY FAIL TO FILE AFTER  
OFFICIAL NOTIFICATION OF THE  
DELINQUENCY, AS REQUIRED BY LAW.

### **Delinquent Filers not Penalized**

The Tax Commission has not adequately assessed late penalty and interest charges to businesses filing returns after the due date. In a random sample of 138 businesses filing delinquent returns, 13 (9.4%) were not assessed late charges as prescribed by law. Some returns filed six months late were not assessed penalties and interest. By not assessing late penalty charges and interest, the state lost an estimated \$63,000 in revenue in 1985. Although not a significant amount of money is lost by not penalizing late filers, failing to assess penalties can cause compliance with sales tax laws to decrease.

For example, one business filed a sales tax return, due June 1, 1985, on October 31, 1985. The return was processed as timely, and a penalty charge of \$165 due the state was not assessed. Further, the Commission erroneously awarded the business a \$13 tax break for filing a timely return. Another business filed a delinquent return with a field office. The field office informed the state office to bill the taxpayer a late filing penalty of almost \$600; however, no late charges were assessed.

Section 12-35-1390 of the South Carolina Code of Laws requires a penalty of "twenty-five percent, and, in addition thereto, interest at the rate one-half of one percent per month should be added to the tax" filed after the due date. The penalty and interest rates were changed in September 1985, to charge a 5% per month penalty for late filing, and interest at a rate tied to that charged by the IRS.

According to Tax Commission officials, the mail room has not properly sorted and sent delinquent returns for late charge assessments. Also, some batches of delinquent returns were improperly filed and not assessed.

### **RECOMMENDATION**

THE TAX COMMISSION SHOULD EXAMINE THE  
PROBLEM OF SALES AND USE TAX

DELINQUENCIES NOT BEING ASSESSED A LATE  
CHARGE AND CORRECTIVE ACTION SHOULD BE  
IMPLEMENTED.

### **Closed Businesses**

Companies going out of business are not "desk" audited by the Tax Commission to determine if all taxes due the state are paid. As of December 1985, an estimated 6,000 businesses, some closing two years earlier, had not been reviewed by the Commission to ensure any back taxes owed were paid. The sales tax office audit function policy manual requires that:

The closed accounts are checked on [the]  
CRT to insure all returns are filed up  
to closing date. Accounts with missing  
returns...are assessed or sent for field  
contact.

When closed businesses are not checked for back taxes, the state's financial interest is not adequately protected. The Commission cannot reasonably ensure all taxes due the state are paid. For example, one business closed in August 1984. The August sales tax return was not filed, and an estimated \$500 in back taxes, based on past liabilities, could be due the state.

According to one Tax Commission official, the review of closed businesses ceased in May 1985 because of a backlog of other work. In January 1986, when examined by the Audit Council, action was taken to more quickly process closed business accounts.

### **RECOMMENDATION**

THE TAX COMMISSION SHOULD IMPLEMENT A  
SYSTEM TO ENSURE CLOSED BUSINESSES ARE  
CHECKED TO DETERMINE IF ALL RETURNS ARE  
FILED.

### Delinquent Filer Bonds

The Tax Commission has not required businesses delinquenty paying their sales tax to post a bond. Tax Commission officials and records indicate that a minimum of 8,000 businesses should be posting bonds for filing two late returns in a 12-month period.

Further, from April 1985 through March 1986, over 500 taxpayers wrote two or more bad checks to the Commission. For example, one taxpayer wrote four bad checks ranging from \$3,500 to \$6,500 each.

Section 12-54-200 of the South Carolina Code of Laws prescribes that the Commission, after notification, may require the taxpayer "to post a cash or surety bond if the person fails to file a timely return or pay any tax for as many as two tax filing periods in a 12 month period." The bond can be for up to three times the estimated average liability for the filing period. A Tax Commission internal study stated:

If an account which is scheduled for monthly filing of returns has two delinquencies in the previous twelve months, then an automatic letter should be mailed requiring that bond be posted.

Section 34-11-70 makes it a crime to write a check without sufficient funds in the bank.

Without requiring businesses to post a bond, the Commission cannot adequately ensure taxes due the state are collected from "problem" businesses failing to file or pay. The state's interest cannot be adequately protected and safeguarded.

State law does not prescribe bonding of taxpayers consistently writing bad checks. Bonding may help to protect the state's interest from problem check writers.

### RECOMMENDATIONS

THE TAX COMMISSION SHOULD ESTABLISH A  
SYSTEM TO IDENTIFY AND NOTIFY BUSINESSES

REQUIRED TO POST A CASH OR SURETY BOND  
AS PRESCRIBED BY LAW.

THE GENERAL ASSEMBLY SHOULD CONSIDER  
REQUIRING TAXPAYERS WRITING TWO OR MORE  
BAD CHECKS IN A YEAR TO POST A CASH OR  
SURETY BOND WITH THE COMMISSION.

THE TAX COMMISSION SHOULD FILE CRIMINAL  
CHARGES WHEN A TAXPAYER CONTINUALLY  
WRITES BAD CHECKS TO THE TAX COMMISSION.

### **Sales Tax Error List**

The Tax Commission's list of businesses underpaying or overpaying sales taxes owed to the state needs to be processed in a timely manner. As of December 1985, an estimated 116,000 taxpayer errors, dating back to October 1984, were identified by the computer. According to Commission officials, the agency is 15 months behind in processing tax return errors which have been identified.

For example, in April 1985, one business underpaid its sales tax by over \$1,100. As of December 1985, the business had not been notified by the Commission of this underpayment. Based on the backlog of errors, this business would not be notified until July 1986 that the April 1985 taxes were underpaid.

In addition, businesses claiming more than the allowable deduction for timely filing of sales tax returns are not timely notified that they owe additional taxes. In FY 83-84, businesses filed and were granted a larger tax break than allowed by law. In January 1986, the Commission finished notifying those businesses that they owed additional taxes (see p. 51).

The Tax Commission Office Audit responsibilities require that tax errors identified by the computer be reviewed and processed for additional taxes or a refund, if

necessary. Office Audit also determines which businesses claim larger than allowable tax deductions for "timely filing." To be fair to the taxpayer, a good practice would be to notify businesses immediately that an error was made on their return and that additional taxes are owed to the state.

When errors are not promptly reviewed and disposed of, the Commission cannot ensure sales taxes due the state are collected in a timely manner. Further, it is unfair to taxpayers to be issued a notice that a sales tax return, filed up to two years earlier, was underpaid.

According to Tax Commission officials, the computer identifies too many errors to review and process in a timely manner. However, the Commission is studying a method to more efficiently process tax errors generated by the computer.

### **Sales Taxpayers' Penalties**

The Tax Commission does not penalize sales taxpayers who claim more than the legally allowed annual deduction for the timely filing of sales tax returns. The Commission has not penalized taxpayers for taking an annual deduction larger than allowed, although both state law and sales tax returns outline the maximum annual deduction and states that it cannot be exceeded. (As of July 1, 1984, the maximum allowable annual deduction was increased from \$5,000 to \$10,000.) Taxpayers who claim more than the allowable deduction are assessed the amount improperly taken, with interest, but no penalty is applied. In FY 83-84, one taxpayer improperly claimed over \$12,000 in the timely payment discount without being penalized.

Section 12-35-1230 of the South Carolina Code of Laws allows sales and use taxpayers to take either a 2% or 3% deduction on the amount of tax owed if they file and pay the tax "on or before the final due date." Section 12-54-40 states:

In case of failure to pay any tax on or before the date prescribed by law... there must be added to the tax due a penalty...

Furthermore, the Tax Commission has penalized sales and use taxpayers who claim the 2% or 3% timely payment deduction when they file a late return.

By not penalizing taxpayers who claimed more than the allowable annual deduction, based on Commission records, the state lost approximately \$25,000 in FY 83-84.

Tax Commission officials stated that they waived the penalties owed on sales tax not paid by claiming more than the maximum allowable deduction because the taxpayers had made a "good faith effort" to comply with the law. Yet, Tax Commission sales and use tax forms state the maximum allowable annual deduction for timely filing.

#### RECOMMENDATIONS

THE TAX COMMISSION SHOULD ENSURE THAT SALES TAX RETURNS IDENTIFIED AS CONTAINING ERRORS IN THE AMOUNT OF TAX OWED ARE REVIEWED AND PROCESSED IN A TIMELY MANNER.

THE TAX COMMISSION SHOULD IMPLEMENT A SYSTEM TO DISALLOW THE "TIMELY FILING" DEDUCTION AFTER THE MAXIMUM DEDUCTION ALLOWED BY LAW HAS BEEN REACHED.

THE TAX COMMISSION SHOULD ASSESS PENALTIES ON THE AMOUNT OF SALES TAX NOT PAID BY BUSINESSES CLAIMING MORE THAN THE ALLOWABLE ANNUAL DEDUCTION FOR THE TIMELY FILING OF THEIR RETURNS.



### Permanent Sales Tax Filing Extensions

The Tax Commission has granted 67 taxpayers permanent 10-, 20-, or 30-day extensions for the filing and payment of their sales tax each month. However, the Commission has not ensured these taxpayers paid interest for the "late" payment of their sales tax as required by state law. For example, no interest was assessed one taxpayer although the taxpayer attached to his monthly returns the Commission's letter granting the permanent extension which stated:

Provided, that the interest provided for in Section 12-35-1220 relating to extension of time for filing and paying the tax, shall not be waived or reduced by the Commission. [Emphasis Added]  
(The Commission is allowed by law to assess interest and back taxes for three years.)

Furthermore, the Commission allowed the permanent extensions to cover sales tax prepayments.<sup>3</sup> By granting extensions for prepayments, over \$5.3 million in prepayments has been paid "late" from May 1983 to April 1986 without the taxpayers having to pay interest. One retailer paid over \$4 million late without having to pay any interest or penalties. By granting this one taxpayer a permanent extension, the state suffered a loss in interest income of approximately \$35,000 during this period. The sales tax prepayment law does not specify that interest is to be charged for late payment, and since the taxpayers are paying late under an extension, no penalties can be applied by law.

While state law allows the Commission to grant extensions for "good cause" if the request is filed before the due date, there is no statutory provision stating the Commission can grant permanent extensions. Furthermore, state law allows sales taxpayers granted an extension to

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<sup>3</sup>For a discussion of the sales tax prepayment law, see page 41.

still take the timely payment discount of 2% or 3% of the tax due (see p. 44). Therefore, these taxpayers who are paying their sales tax "late" every month are allowed a timely payment discount. The timely payment discount law was passed to encourage the "timely" payment of taxes. Allowing taxpayers who pay "late" every month to take the discount may not meet the intent of the law.

In addition, §12-54-70 of the South Carolina Code of Laws requires the Commission to deny requests for extensions to taxpayers who failed to comply with the requirements of a previously granted extension. Thus, the Commission is required to rescind the permanent extension for sales taxpayers who have not met the interest requirement of their extension.

#### **RECOMMENDATIONS**

ALL SALES TAXPAYERS WITH PERMANENT EXTENSIONS SHOULD BE ASSESSED UNPAID INTEREST AS REQUIRED BY LAW. THE ASSESSMENT SHOULD EXTEND BACK THREE YEARS AS ALLOWED BY THE STATUTE OF LIMITATIONS.

THE COMMISSION MUST RESCIND THE PERMANENT EXTENSIONS FOR SALES TAXPAYERS WHO HAVE NOT MET THE INTEREST REQUIREMENT OF THEIR EXTENSION.

THE GENERAL ASSEMBLY SHOULD CONSIDER AMENDING THE SALES TAX TIMELY PAYMENT DISCOUNT LAW TO SPECIFICALLY DISALLOW THE DISCOUNT TO TAXPAYERS WITH PERMANENT EXTENSIONS, AND TO REQUIRE INTEREST TO BE PAID ON SALES TAX PREPAYMENTS PAID LATE UNDER AN EXTENSION.

### **Multilocation Sales Taxpayers**

The Commission could more effectively monitor multilocation sales taxpayers if several changes were made. Multilocation taxpayers are those with multiple retail outlets, such as restaurant and grocery store chains. Instead of filing a return for each retail license, 834 such taxpayers, holding 6,257 retail licenses, report on one return their total sales from all outlets. The following would improve the Commission's monitoring of the largest sales taxpayers in the state.

### **Reporting by Location**

State law requires multilocation taxpayers to report sales by each location as opposed to total company sales. The Tax Commission could save approximately \$83,000 annually, and more effectively monitor these sales taxpayers (see p. 56) if they were allowed to report only total aggregate sales. Savings would occur through reductions in tax return processing and data entry keypunch time as well as printing costs. Also, businesses would benefit by reduced reporting requirements.

The Commission does not need or use information for each location, but only needs the "bottom line" information. Because detailed information is required, multilocation taxpayers, who file only one monthly return must report on special forms ten times larger than the regular sales tax form. The 834 multilocation tax returns cost the Commission 56% as much to process as the other 60,000 sales tax returns submitted each month.

Section 12-35-570 of the South Carolina Code of Laws was amended in 1983 to require multilocation taxpayers to report to the Tax Commission the retail sales by each location they have. If multilocation taxpayers were not required to report by each retail license held, the Commission would save approximately \$48,000 annually in

processing costs, \$33,000 in data entry costs, and \$2,000 in printing costs.

According to Tax Commission officials, §12-35-570 was amended by the General Assembly requiring multilocation taxpayers to report by location in order to provide the State Development Board with detailed information on retail sales. However, the costs and benefits of gathering and providing this information were not studied.

### **Manual Monitoring of Large Sales Taxpayers**

The Commission's current system requires staff to monitor multilocation retailers manually. If the Commission would enter into the computer the grand totals reported on multilocation returns, the Commission would no longer have to manually monitor payments by the state's largest sales taxpayers. The Commission maintains data on the 6,257 retail licenses these taxpayers hold, and can provide detailed tax return information for each retail license instantaneously to its staff. However, since the grand total is not entered into the system, detailed tax return information on what multilocation taxpayers owed and paid as a single entity cannot be provided. State law requires the Commission to treat a multilocation taxpayer as one entity.

Entering the total sales and tax figures for multilocation taxpayers would cost the Commission \$4,600 annually in additional data entry. However, this would allow the Commission to more easily monitor such taxpayers. Presently, Commission personnel must manually determine if multilocation taxpayers claim more than the \$10,000 timely payment discount allowed annually (see p. 51), or if those multilocation taxpayers required to make sales tax prepayments comply with state law (see p. 41). This hinders the monitoring process, and in some instances has resulted in the Commission not discovering and notifying taxpayers of violating the discount and prepayment laws until 21 months after a return was filed.

Single location taxpayers' detailed tax return data can be retrieved instantaneously on the Commission's computer. However, Commission personnel have two manual options to obtain data on multilocation taxpayers. First, they can request the Sales Tax file room to retrieve the return(s). (In some cases, the returns are not provided until the day after they are requested.) Or, Commission personnel can retrieve from the computer, data on each retail license held by a multilocation taxpayer, and add the information together to obtain total sales and tax figures.

Furthermore, entering in the total sales and tax figures, and rewriting the delinquency notice computer program to use only the grand total figures would reduce the Commission's paperwork, eliminating the printing and handling of multiple delinquency notices. Presently, if a multilocation taxpayer pays his sales tax late, the computer prints out and sends to Office Services a delinquency notice for each retail license. Thus, if the taxpayer owns 67 stores, 67 delinquency notices are printed and processed.

#### RECOMMENDATIONS

THE STATE DEVELOPMENT BOARD SHOULD PROVIDE THE GENERAL ASSEMBLY WITH AN ESTIMATE OF THE BENEFITS DERIVED FROM THE DATA OBTAINED FROM MULTILLOCATION TAXPAYERS REPORTING SALES TAX BY LOCATION.

THE GENERAL ASSEMBLY SHOULD THEN CONSIDER AMENDING §12-35-570 OF THE SOUTH CAROLINA CODE OF LAWS TO NO LONGER REQUIRE MULTILLOCATION TAXPAYERS TO REPORT SALES TAX BY LOCATION.

THE TAX COMMISSION SHOULD ENTER INTO THE COMMISSION'S COMPUTER THE GRAND TOTAL

FIGURES ON MULTILOCATION SALES TAX  
RETURNS.

**Reporting on a 13-Period Basis**

The Tax Commission allows some taxpayers to file and pay their sales tax 13 times per year. (Neither the Commission nor the Audit Council could determine the number of businesses who report on a 13-period basis.) However, state law requires sales taxes to be reported on a monthly basis (in some cases quarterly). Section 12-35-570 of the South Carolina Code of Laws states:

[Sales]...taxes...are due and payable in monthly installments on or before the twentieth day of the month next succeeding the month in which the tax accrues.

By allowing some sales taxpayers to pay and report their taxes on a 13-period basis instead of monthly, the Commission is not in compliance with state law. These special exceptions increase administrative time necessary to monitor payment because the Commission's computer is not programmed to track such "exceptions."

The reporting of sales taxes on a 13-period basis increases the state's interest income by getting the tax in the state's bank accounts earlier. However, if the choice to pay on either a monthly or 13-period basis is warranted, the Commission should request legislative changes.

**RECOMMENDATION**

IF A 13-PERIOD PER YEAR DUE DATE IS  
WARRANTED, THE COMMISSION SHOULD REQUEST  
AMENDMENT OF §12-35-570 OF THE SOUTH  
CAROLINA CODE OF LAWS.

**Corporate Income Tax Administration**

The Council examined the Commission's system for ensuring corporations file returns and pay taxes as

required. Several problems were found which must be corrected to ensure these taxes are properly administered.

### **Corporations not Filing Income Tax Returns**

The Tax Commission has not taken adequate action against corporations not filing their income tax returns. As of February 1986, over 1,700 corporations had not filed an income tax return for 1983. Additionally, 5,400 corporations had not filed returns for 1984. (Some did not file for both years). Collections for these delinquencies were not being pursued as of March 1986, four months after amnesty ended.

Although the Commission sent these corporations "arbitrary" assessments of over \$6 million for failure to file 1983 and/or 1984 returns, the Commission has not followed up to collect funds owed to the state (the amount actually collectable could not be determined).

For example, one corporation failed to file a 1983 corporate income tax return. On July 16, 1984, the Tax Commission sent an "arbitrary" assessment of \$910.50 for taxes and penalties not paid. The assessment stated if not paid in ten days, a warrant would be issued. As of February 1986, a warrant had not been issued, and no other efforts to collect funds owed to the state were made. Tax Commission records indicate that this company is still in business.

One corporation failed to file a return due January 15, 1985. On May 10, 1985, the company was given a refund of over \$800 for prior tax overpayments. Five days later, the company was issued an assessment of \$910.50 for failure to file a return and pay the franchise fee. As of February 1986, no other efforts had been made to collect the taxes owed.

Section 12-7-2720 of the South Carolina Code of Laws states that any corporation failing to file a return shall pay, in addition to the tax due, a 5% penalty (and appropriate interest). Further, state law requires:

If the tax and all applicable penalties and interest are not paid within ten days from the date of demand by the Commission, the Commission shall issue a warrant for the collection thereof as is provided by this chapter.

[Emphasis Added]

By not attempting to collect funds assessed corporations, the Tax Commission cannot adequately ensure corporations pay their share of taxes owed to the state. This is unfair to other taxpayers who must make up the difference to fund state programs.

According to Commission officials, the Commission is in the process of ensuring corporate charters are dissolved if taxes assessed are not paid in a timely manner. The Commission has recommended certain enforcement action to remedy this problem.

#### **System to Assess Corporate Nonfilers**

The Tax Commission's system of assessing estimated income taxes for corporations not filing a return has been inadequate. Estimated taxes have not been based on previous tax liabilities. Instead, the Commission estimated taxes at \$200 for all corporations failing to file.

For example, one corporation failed to file its 1984 corporate income tax return. In 1983, this company paid corporate income taxes of over \$4,000; however, the Commission estimated this company's liability at \$200. Another corporation paid over \$2,000 for 1983 income taxes. When the company failed to file a 1984 return, the company was assessed estimated taxes of \$200.

Section 12-7-1670 of the South Carolina Code of Laws allows the Commission to estimate tax liabilities based on past tax liabilities. Also, other departments in the Tax Commission assess taxpayers based on previous liabilities. For example, a sales taxpayer failing to file a return is assessed "based on 1½ times the taxpayer's average monthly sales tax plus applicable penalties and interest."



According to the Tax Commission, a system to assess corporations based on past liabilities was implemented in April 1986.

#### **RECOMMENDATION**

THE TAX COMMISSION SHOULD ENSURE THAT CORPORATIONS NOT FILING AN INCOME TAX RETURN AS REQUIRED ARE DEALT WITH IN ACCORDANCE WITH STATE LAW.

#### **Estimated Tax Payments and Employee Withholding**

The Audit Council examined the Tax Commission's system for enforcing quarterly corporate and individual estimated tax payment laws. In addition, the Commission's system for tracking, collecting and accounting for taxes withheld from employees' paychecks (employee withholding taxes) was examined. Problems which affect compliance with estimated tax payments and withholding tax laws were found.

These problems have been reviewed with the Tax Commission. The majority of the Audit Council's concerns in these areas are being addressed by the Commission's new computer system. Any member of the General Assembly wanting additional information concerning estimated tax payments and employee withholding taxes should contact the Legislative Audit Council or the Tax Commission.

#### **Bonding of Individual Income Tax Withholding Accounts**

The Tax Commission does not require withholding accounts which are delinquent or not paid twice within a 12-month period to post a cash or surety bond. This would help to protect the interest of the state, and would encourage maximum compliance by problem businesses. Commission officials have estimated that 20% of all withholding returns are filed late.

Section 12-54-200 of the South Carolina Code of Laws allows the Commission to:

...require any person subject to provisions of law administered by the Commission...to post a cash or surety bond if the person fails to file a timely return or pay any tax for as many as two tax filing periods in a twelve-month period.

In addition, out-of-state contractors are required by state law to post a bond for 2% of each contract over \$10,000 which they are awarded. This helps to guarantee that contractors pay the individual income tax required to be withheld from their employees' paychecks.

The Commission could increase protection of the state's interest by requiring problem withholding accounts to be bonded. Bonding of these accounts would give the state a source of funds to levy on in case of continued late payments or nonpayment of taxes owed.

#### **RECOMMENDATION**

THE TAX COMMISSION SHOULD CONSIDER  
REQUIRING EMPLOYERS WHO PAY THEIR  
WITHHOLDING ACCOUNTS LATE, OR WHO FAIL  
TO PAY THEIR WITHHOLDING ACCOUNTS TWICE  
WITHIN A 12-MONTH PERIOD, TO POST A CASH  
OR SURETY BOND.

#### **Individual Nonfilers**

The Tax Commission, until 1986, had not ensured that individuals file individual tax returns as required by law. For example, the Commission had considered but did not implement the following programs:

- There is no program to identify individuals filing one year but not the next, or determine why they are not filing. Previously, the Commission found attorneys and other professionals who filed some years, but discontinued to file when they were still required to file.
- The Commission has no program to determine if individuals with W-2 income reported to the Commission by their employers actually file a tax return.

Recently, the Commission began matching records of individuals filing federal returns from South Carolina to determine if state returns were filed. In that process, 52,000 individuals were identified as having filed 1983 federal returns, but not filing 1983 state returns. According to Tax Commission officials, many of the 52,000 individuals, such as certain military personnel and nonresidents, may not be required to file state returns. Additionally, an IRS match of South Carolina businesses to determine reporting discrepancies has been conducted.

The need to be more aggressive in pursuing individual nonfilers has been recognized by the Commission. In an internal study conducted in 1985, the Commission suggested certain programs to detect nonfilers.

#### **RECOMMENDATION**

THE TAX COMMISSION SHOULD CONTINUE TO MATCH INFORMATION WITH FEDERAL DATA TO IDENTIFY NONFILERS. TO IDENTIFY NONFILERS, THE COMMISSION SHOULD CONSIDER IMPLEMENTING OTHER PROGRAMS, SUCH AS MATCHING WAGE INFORMATION REPORTED BY EMPLOYERS WITH RECORDS OF INDIVIDUALS FILING RETURNS. THE COMMISSION SHOULD MATCH TAXABLE INCOME REPORTED TO THE TAX COMMISSION TO THAT REPORTED TO THE IRS TO VERIFY THE ACCURACY OF TAX RETURNS.

#### **Income Tax Extensions**

The Tax Commission has not ensured that individuals granted a 120-day extension to file their income tax return file their tax returns as required. In December 1985, the Commission identified 9,590 individuals granted an extension for their 1984 income tax who may not have filed a return. During the Council's review, those individuals not filing

had not been notified by the Tax Commission that they are required by law to file a return.

Sections 12-7-1640 and 12-54-70 of the South Carolina Code of Laws allow the Commission to grant an extension for the filing of tax returns on the showing of good cause.

(However, such an extension may not be granted if the taxpayer had in a prior period been granted an extension and did not fulfill the requirements of the previous extension.) The Tax Commission grants such extensions for individual income tax returns for 120 days.

In 1981, an attorney was found to have requested an extension to file his 1978, 1979, and 1980 individual tax returns but did not file. (Also, there is no record that he filed a return or requested an extension for tax years 1971, 1972, 1973, or 1977.) When detected, the attorney stated, "it was never my intent to do anything other than file my tax returns and pay taxes owed." The attorney was not referred for prosecution, and negligence penalties were waived by the Commission.

In a random sample of 129 individual income tax extensions granted for 1984, 23 individuals (19.7%) granted an extension did not file a return. The Audit Council estimates that approximately 3,700 individuals granted a 120-day extension to file their 1984 individual income tax return failed to file such a return. Furthermore, an estimated 800 individuals who were also granted an extension, but did not file their 1984 income tax returns, were granted an extension in 1983, but did not file a return for that year. The Commission must be committed to ensuring that individuals filing an extension to file their return do actually file.

#### **RECOMMENDATION**

THE TAX COMMISSION SHOULD ENSURE THAT  
INDIVIDUALS GRANTED A FILING EXTENSION

FILE THEIR TAX RETURNS. THE COMMISSION SHOULD NOTIFY THOSE INDIVIDUALS GRANTED A FILING EXTENSION BUT WHO FAIL TO FILE THEIR RETURN AFTER THE EXPIRATION OF THE 120-DAY EXTENSION PERIOD. IF THESE INDIVIDUALS STILL DO NOT FILE THEIR RETURNS, THE TAX COMMISSION SHOULD, WHEN APPROPRIATE, AUDIT SUCH INDIVIDUALS AND ASSESS THEM FOR ALL TAXES, PENALTIES, AND INTEREST, AND INITIATE CRIMINAL CHARGES IF WARRANTED.

### **Processing of Federal Revenue Agents' Reports**

The Tax Commission could collect an additional \$475,000 annually by requiring individuals audited by the IRS to file an amended state return and pay additional state taxes owed. The Tax Commission obtains Revenue Agents' Reports (RARs) from the IRS when it audits a South Carolina taxpayer and finds an increased federal tax liability above an amount specified by the Commission (this amount is confidential). The Commission then reviews the individual's state return, makes adjustments, and bills the taxpayer accordingly. However, if the taxpayer was responsible for making the adjustments, the Commission could process more IRS audited returns (not just those showing a federal tax liability above the specified amount) and obtain more revenue due the state. Further, audit coverage of individuals would be increased.

According to the IRS, approximately 9,500 audits conducted during FY 84-85 might have affected the taxpayers' South Carolina tax liability. The Tax Commission requested 3,500 audits from the IRS. The 6,000 audits not examined by the Commission were those with a federal tax liability under the specified amount. Approximately \$475,000 additional revenue could be obtained annually if these taxpayers paid the additional taxes owed.

Other states maximize use of federal RAR reports. According to a national tax publication, at least 17 states utilize all RARs to maximize state tax revenues.

According to Tax Commission officials, if individuals were required to submit amended returns to the Commission after a federal audit is completed, the agency could process more RARs at less cost. This would allow personnel to be more productive in working RARs. If individuals are not required to provide the state with amended returns, the Commission should still ensure all federal audits are obtained and processed to increase state tax revenues. State law may need to be amended to require the filing of amended returns as the result of an IRS audit.

#### RECOMMENDATIONS

THE TAX COMMISSION SHOULD TAKE APPROPRIATE STEPS TO REQUIRE TAXPAYERS AUDITED BY THE IRS TO FILE AMENDED STATE RETURNS IF ADDITIONAL STATE TAXES ARE OWED. THE COMMISSION SHOULD CHECK AMENDED RETURNS FILED WITH FEDERAL AUDITS (RARS) TO ENSURE THAT AMENDED STATE RETURNS HAVE ALSO BEEN FILED. APPROPRIATE PENALTIES AND INTEREST SHOULD BE APPLIED FOR FAILURE TO FILE AN AMENDED RETURN.

IF STEPS ARE NOT TAKEN TO REQUIRE THE FILING OF AMENDED RETURNS, THE TAX COMMISSION SHOULD PROCESS ALL RARS TO MAXIMIZE USE OF FEDERAL INFORMATION IN OBTAINING ADDITIONAL STATE REVENUE.

#### Abandoned Property

State law requires every person or business to report and turn over to the Tax Commission property which has been

"unclaimed" by its owner for a specified period of time. Financial institutions and insurance companies often are holders of property or accounts that become abandoned. The length of time required for property to become "abandoned" is specified by the type of property held and the type of organization or person holding the property. Once the property is turned over to the state, the owner can at any time regain possession by providing to the Commission proof of ownership.

### **Audits for Abandoned Property**

The Tax Commission did not conduct abandoned property audits from 1973 to July 1985 (excluding one audit in 1979 and audits of electrical co-ops in 1982 and 1983). Furthermore, the Tax Commission has not conducted abandoned property audits of businesses headquartered out-of-state or banks and savings and loans.

The Commission began conducting abandoned property audits again in July 1985. These audits have consisted solely of South Carolina domiciled life insurance companies. This occurred after the state Department of Insurance informed the Commission that a South Carolina-based insurance company held over \$1.3 million worth of abandoned property while reporting to the state it had no abandoned property.

The Audit Council surveyed ten states and was informed that auditing for abandoned property was necessary to ensure firms properly report all abandoned property held. Officials in these states stated that they have found it highly profitable to aggressively audit firms for abandoned property, and they are assisted in deciding who to audit by their state's bank examiners and insurance departments. Officials in New Jersey, Illinois, and Texas stated that they had obtained over \$1 million from individual banks during 1984 through audits. In addition, New York officials

said they collected over \$20 million from abandoned property audits in 1984.

By not auditing businesses for abandoned property from 1973 to July 1985 and now only auditing South Carolina domiciled insurance companies, the Tax Commission has not adequately ensured compliance in this area. Estimates are that \$20 million in abandoned property due the state has not been reported since 1972. Since July 1985, when audits began, the Commission conducted 42 audits resulting in the assessment of approximately \$1 million, including an assessment of over \$424,000 from the insurance company reporting no abandoned property to the Tax Commission.

### **Reporting of Abandoned Property**

The Audit Council reviewed abandoned property reports submitted by banks, savings and loans, and insurance companies and found reporting problems which need to be further investigated and corrected by the Commission. Since 1980, these problems may have cost the state an estimated \$6.3 million in unreported abandoned property held by these institutions.

The Audit Council reviewed the records of the Tax Commission's Abandoned Property Section and found the following:

- Banks and savings and loans which have reported abandoned property to the Tax Commission have reported only dormant savings and checking accounts. They have not reported outstanding traveler's checks, outstanding money orders, or abandoned safety deposit boxes.
- Four savings and loans with assets from \$110 million to \$250 million reported no abandoned property to the Commission from 1980 to 1984.
- Life insurance companies doing approximately the same amount of business in South Carolina are remitting widely varying amounts of abandoned property.
  - (a) One company, which did \$29 million worth of business in 1984, turned over \$158,000 in abandoned property to the Commission from 1981 to 1985, while a company doing \$22 million worth of



business turned over only \$2,318 during the same five-year period.

- (b) Three insurance companies that did from \$10 million to \$12 million worth of business in 1984 also turned over widely differing amounts of abandoned property in 1985. One turned over \$19, while the other two turned over \$10,800 and \$15,500. The reasons for these variances and other large differences were not investigated by the Commission.
- A life insurance company with \$9 million worth of business in South Carolina in 1984 is not on the Tax Commission's abandoned property mailing list.
- The state Department of Insurance, in a routine audit of a South Carolina-based insurance holding company, found it had, since 1972, retained \$1.3 million worth of abandoned property while reporting to the Tax Commission it held no abandoned property.

These problems exist because the Commission has not analyzed information received from businesses reporting abandoned property. Further, the Commission has not actively tracked businesses which should be filing abandoned property reports. Additionally, only one audit to determine compliance of insurance companies' banks and savings and loans with abandoned property laws was conducted from 1973 to July 1985 (see p. 67), and since the Commission began conducting abandoned property audits again in July 1985, it has audited only South Carolina domiciled life insurance companies.

State officials in Florida, Virginia, and Texas stated to the Audit Council that financial institutions with \$500 million worth of assets should be turning over to the state a minimum of \$25,000 annually in abandoned property. According to these officials, even the smallest banks should annually be reporting dormant savings and checking accounts, outstanding traveler's checks, outstanding money orders, and abandoned safety deposit boxes. In addition, the state Department of Insurance told the Audit Council that similarly situated life insurance companies doing

approximately the same amount of business in South Carolina should be reporting approximately the same amount of abandoned property. Based on other states' experiences and Department of Insurance information, insurance companies, banks, and savings and loans may have underreported and underremitted over \$6.3 million in abandoned property to the Commission between 1981 and 1985.

### RECOMMENDATIONS

THE TAX COMMISSION SHOULD CONDUCT ABANDONED PROPERTY AUDITS OF BANKS, SAVINGS AND LOANS, AND OUT-OF-STATE BUSINESSES, IN ADDITION TO AUDITING SOUTH CAROLINA DOMICILED LIFE INSURANCE COMPANIES.

THE COMMISSION SHOULD CONDUCT ABANDONED PROPERTY AUDITS WHENEVER BUSINESSES ARE AUDITED FOR INCOME TAX PURPOSES OR THE COMMISSION HAS REASON TO BELIEVE THE BUSINESSES ARE UNDERREPORTING THE AMOUNT OF PROPERTY DUE THE STATE.

THE STATE BOARD OF FINANCIAL INSTITUTIONS SHOULD REPORT TO THE COMMISSION FINANCIAL INSTITUTIONS BELIEVED TO BE UNDERREPORTING THE AMOUNT OF ABANDONED PROPERTY THEY HOLD.

THE TAX COMMISSION SHOULD ACTIVELY TRACK THE AMOUNT AND TYPE OF ABANDONED PROPERTY REPORTED AND TURNED OVER TO THE COMMISSION BY THE STATE'S FINANCIAL INSTITUTIONS AND INSURANCE COMPANIES. THIS INFORMATION SHOULD BE COMPARED WITH THE AMOUNT OF ASSETS AND PREMIUMS

WRITTEN, AS WELL AS WITH THE AMOUNT OF  
ABANDONED PROPERTY REPORTED AND PAID BY  
SIMILARLY SITUATED INSTITUTIONS.  
DISCREPANCIES SHOULD BE REVIEWED FOR  
POSSIBLE FIELD AUDIT TO ENSURE  
COMPLIANCE.

### System for Notifying and Assessing Delinquent Filers

Office Services' system for processing delinquencies is inconsistent and does not comply with state law. The amount of time taken to issue to taxpayers a "first notice" of a delinquency varies by type of tax (sales, withholding, etc.). Further, the amount of time taken to assess a taxpayer or issue a warrant to enforce collections varies. Table 3 outlines the inconsistent delinquent collection processes for three taxes.

TABLE 3  
VARIANCES FOR PROCESSING DELINQUENCIES FOR THREE TAXES

<u>Type Tax</u>	<u>Approximate Number of Days</u>		
	<u>Delinquent<sup>1</sup> Before 1st Notice</u>	<u>Between 1st Notice<sup>2</sup> and Assessment</u>	<u>Between Assessment<sup>3</sup> and Warrant</u>
Sales and Use	20	60	25
Withholding <sup>4</sup>	30	40	45
Corporate Income	60	60	60

<sup>1</sup>Official notice to taxpayer of delinquency.

<sup>2</sup>Estimate of taxes owed, issued when delinquency not resolved.

<sup>3</sup>Process for seizing taxpayers' assets to satisfy debts.

<sup>4</sup>For quarterly reports and annual reconciliation reports only.

Source: South Carolina Tax Commission records.

Prompt notification of delinquencies to taxpayers would help resolve delinquencies in a more timely manner. The Tax Commission has recognized this problem and recommended that delinquencies be processed completely in 90 days. Further,

state law requires that taxpayers be assessed for estimated taxes if the taxes are not paid after notification of delinquency. If not paid within ten days of assessment, a warrant for distraint is required to be filed.

Delinquencies must be processed in a timely manner to help ensure collection. In FY 84-85, the Commission "wrote off" over \$18.8 million as uncollectible.

Presently, delinquencies cannot be processed in a timely manner because of computer processing delays. Delinquency notices are not generated for at least 20 days after a return becomes delinquent because it takes that long to update the computer (see p. 81).

#### RECOMMENDATION

THE TAX COMMISSION SHOULD STANDARDIZE ITS SYSTEM FOR NOTIFYING TAXPAYERS OF DELINQUENCIES. ADDITIONALLY, THE COMMISSION'S SYSTEM FOR ASSESSING AND FILING WARRANTS TO TAXPAYERS NOT PAYING TAXES DUE SHOULD BE STANDARDIZED IN ACCORDANCE WITH STATE LAW.

**CHAPTER III**  
**ADMINISTRATION, TAX REFORMS, AND COMPUTER FUNCTIONS**

The Council reviewed administrative functions, computer operations, and tax reforms.

**Tax Reforms**

The Council examined the possibility of several tax reforms, and the recent individual income tax reform, and found the following.

**State Agencies Paying Sales Tax**

State regulations require state agencies to pay state sales tax on purchases. This could cost the state an estimated \$1.5 million annually in lost revenue and interest. State Regulation 117-174.94, promulgated by the Tax Commission in 1976, requires the payment of sales tax on sales to the state.

Whenever a state agency purchases items or services subject to the state's sales tax, the state pays the business the 5% sales tax. The business then holds this 5% tax until it is required to pay the 5% tax back to the Tax Commission. However, if the business pays the Tax Commission its sales tax due by the 20th day of the next month, the business can take a 2% discount for timely filing. For example, if the Tax Commission, or any other state agency, buys \$100,000 worth of office furniture from a business in South Carolina, the Tax Commission must pay the business the 5% sales tax of \$5,000. Then by the 20th day of the next month, the business is required to pay the \$5,000 back to the Tax Commission, minus the timely filing discount. Thus, although the Tax Commission paid the business \$5,000 in sales tax, the business only pays back to the Tax Commission \$4,900 in sales tax. By paying sales tax on this purchase, the state directly loses \$100 (due to the 2% discount), and lost interest which it could have received

from having the \$5,000 continuously invested in the state's investment portfolio.

State officials in Georgia informed the Audit Council that sales to Georgia state agencies are exempted from the Georgia sales tax. Additionally, state law exempts from state sales tax most purchases made by the federal government in South Carolina.

The Audit Council estimates that the state may have paid \$50 million in sales tax to itself in FY 84-85. By giving this \$50 million to vendors to hold for an average of 35 days before turning back only \$49 million to the state, the state unnecessarily may have lost approximately \$1 million due to the 2% discount and \$500,000 in interest.

#### **RECOMMENDATION**

THE TAX COMMISSION SHOULD AMEND STATE  
REGULATION 117-174.95 TO EXEMPT THE  
PAYMENT OF SALES TAX ON SALES TO THE  
STATE.

#### **Benefits of Individual Income Tax Conformity**

The changing of the state's individual income tax law in 1985 to conform to the Internal Revenue Service (IRS) Code will save the Tax Commission approximately \$90,000 annually in reduced printing, processing, keypunching, and error costs. Furthermore, the new tax form will allow the Commission, by more adequately utilizing tape match programs with IRS data, to ensure the accurate reporting of income information to the state by taxpayers. By having one set of rules and regulations to comply with, the changes simplified the taxpayers' task of complying with the tax laws. In addition, the changes simplified for taxpayers the task of filling out the state's return. The new long tax form, used by a married couple who filed a combined return in 1984, required approximately 63% fewer computations and 88 fewer steps to complete than the 1984 return.

Tax Commission officials estimate that, due to fewer tax schedules, shorter instructions, and increased use of the state's short tax form, the changes will save the Commission \$21,000 in 1986, and \$40,000 in 1987 in printing costs. The new forms saved the Commission \$17,000 by reducing data entry of information by an estimated 28 million key strokes. The new forms saved approximately \$16,000 in reduced coding and verifying of information on the returns. In addition, the simplified forms reduced the tax forms with errors on them from 20% to 4%. Approximately 80,000 fewer errors were handled by the Commission's Office Audit section for an estimated savings of \$32,000. Furthermore, a change in how the Tax Commission's mail room handled the returns saved an estimated \$1,000.

#### **Neutrality of 1985 Individual Income Tax Revision**

The Tax Commission recommended in 1985 that the General Assembly revise the state's individual income tax law to conform to the income tax provisions of the Internal Revenue Code. The Commission proposed legislation that it stated to the General Assembly was "revenue neutral (i.e. the changes would have no effect on the amount of revenue raised by the tax)." The General Assembly subsequently passed the Commission's proposed "revenue neutral" income tax changes. However, based upon research by the Tax Commission, the Commission did not adequately verify the changes were revenue neutral.

A review of the Tax Commission's working papers showing the neutrality of the 1985 individual income tax changes revealed:

1. The Commission did not select a statistically valid sample of 1984 income tax returns to study the effect of the proposed tax changes.
2. The Commission used mismatched data. In examining the revenue effect of the proposed changes from one deduction, the Commission used 1982 federal income tax data to compare with 1983 state income tax data.

3. The Commission used figures which its own data shows were incorrect.
4. In one case, because it was using 1982 data, the Commission adjusted the figures for the effect of inflation between 1982 and 1985. In all other cases where it used 1982 data, the Commission did not adjust for inflation.
5. The Commission used different estimated average tax rates to determine the effect of some changes without researching what the average rates actually were.
6. The Commission estimated \$7 million worth of changes based "upon experience of personnel."

Tax Commission officials stated that to have accurately measured the effect of the proposed tax changes, they should have selected a sample of 1984 returns and reworked them using the proposed 1985 individual income tax form. They stated this was not done, however, because they lacked the necessary personnel. To have been statistically significant at the 95% confidence level with an error rate of +/- 1%, the Commission needed to select a random sample of 3,456 returns. If the Commission did not have the personnel to accurately measure the effect of their proposed changes on the \$850 million annual income tax, they could have requested help from the Budget and Control Board's Division of Research and Statistical Services, or hired an outside consultant.

By not selecting a statistically valid sample of 1984 individual income tax returns to measure the effect of their proposed changes, the Commission may have given the General Assembly inaccurate information. Accurate information is needed when proposing changes to a tax which raised \$850 million in FY 84-85, or 35% of the state's General Fund revenue.

In October 1986, legislation was passed which substantially altered the federal income tax laws beginning with the 1987 tax year. Since South Carolina's income tax is tied to the IRS code, the changes mandated by this



legislation will have a direct impact upon the amount of revenue raised from the state's income tax. Research thus is required to determine the actual effect the federal legislation will have on state revenue.

### **Highway Use Tax**

The highway use tax is inefficient to administer and could be eliminated without reducing state revenues.

Elimination of the highway use tax would have the following savings and effect on the Tax Commission.

1. Eliminate the handling, processing, filing, and storage of 140,000 returns annually.
2. Decrease data entry and computer costs by \$24,000 annually.
3. Decrease processing costs by \$17,000 annually.
4. Eliminate buying 160,000 highway use tax returns for an annual savings of \$9,600.
5. Eliminate having to process 16,000 highway use tax audit errors at an annual cost of \$64,000.
6. Eliminate having to process 16,500 automatically generated highway use tax assessments at an annual cost of \$66,000.
7. Eliminate the need to file 12,000 warrants annually against motor carriers for failure to file or pay their highway use taxes. The Tax Commission is charged by the counties \$2 for each warrant filed at the courthouses. Thus, an annual savings of \$24,000 could be realized.

Eliminating this tax, and raising the cost of the state's motor carrier registration sticker to offset reduced revenues, would decrease paperwork for the trucking industry and the Commission by establishing a taxing mechanism which would be easier to administer.

The tax on diesel fuel is 13 cents per gallon. However, under the highway use tax, motor carriers actually pay tax on the number of gallons of fuel they use in the state instead of the number of gallons they buy. If a

carrier buys fuel in South Carolina, taxed at 13 cents per gallon, but drives on this fuel outside the state, he can file with the Tax Commission for a tax refund on the fuel used to drive out-of-state. On the other hand, if a carrier buys fuel in another state and drives on that fuel in South Carolina, 13 cents is owed for each gallon of fuel burned in South Carolina.

In FY 84-85, the Commission received \$35 million from the tax on diesel fuel collected at the pump for the Highway Department. Also, the state raised approximately \$6,360,000 through the highway use tax and motor carrier registration stickers in FY 84-85. In the registration license year ending September 30, 1985, the Tax Commission collected \$2,344,474 from selling motor carrier registration stickers. The Commission sold 477,236 out-of-state registration stickers at \$4, and 30,965 in-state registration stickers at \$1. In addition, the Commission collected \$405,000 from selling 26,971 10-day temporary motor carrier registration stickers for \$15 each. (Holders of the 10-day temporary stickers are not required to pay the highway use tax.) If these approximately 535,000 registered motor carriers had paid \$16.00 for their registration stickers, the state would have collected over \$8.5 million. If the \$8.5 million raised was offset by \$2.2 million in refunds issued in FY 84-85 for fuel bought in South Carolina but also taxed in another state, approximately \$6.3 million would still be raised annually.

#### RECOMMENDATIONS

THE TAX COMMISSION SHOULD REVIEW ALL OF  
THE STATE'S TAX LAWS AND TAX RETURN  
FORMS FOR POSSIBLE SIMPLIFICATIONS THAT  
ARE REVENUE NEUTRAL.

THE BUDGET AND CONTROL BOARD SHOULD  
IMMEDIATELY COMMISSION A CONSULTANT TO

VERIFY THE IMPACT THE NEW FEDERAL INCOME TAX LAWS WILL HAVE ON THE AMOUNT OF REVENUE RAISED FROM THE STATE'S INDIVIDUAL INCOME TAX. THE TAX COMMISSION SHOULD WORK WITH AND PROVIDE THE CONSULTANT WITH ALL NECESSARY DATA. THE CONSULTANT SHOULD ISSUE TO THE GENERAL ASSEMBLY, DURING ITS 1987 SESSION, A REPORT OUTLINING CHANGES TO THE STATE'S INDIVIDUAL INCOME TAX LAW WHICH WILL NEUTRALIZE THE IMPACT THE FEDERAL CHANGES WILL HAVE ON STATE REVENUE.

FUTURE CHANGES TO TAX LAWS SHOULD BE CAREFULLY RESEARCHED TO ADEQUATELY VERIFY THEIR REVENUE IMPACT.

THE GENERAL ASSEMBLY SHOULD CONSIDER ELIMINATING THE HIGHWAY USE TAX ON MOTOR CARRIERS WHILE MAINTAINING THE TAX ON DIESEL FUEL, AND CONTINUING TO ISSUE REFUNDS FOR FUEL BOUGHT IN SOUTH CAROLINA BUT TAXED IN ANOTHER STATE. THE GENERAL ASSEMBLY SHOULD ALSO CONSIDER RAISING THE COST OF THE MOTOR CARRIER REGISTRATION STICKER TO OFFSET THE LOSS IN REVENUE FROM ELIMINATION OF THE HIGHWAY USE TAX.

#### **Use of Present Tax Commission Computer**

Many problems related to administration of the state's tax laws are caused by inadequacies in the Commission's present computer system. The computer is operated by its Information Resource Management Division (IRM). In 1985, the Tax Commission, developed a plan for a new automated

system, which is scheduled to become completely operational in 1991. (The Council could not determine if this date will be met since the new system is still in the preliminary phase of implementation.)

According to Commission documents, the shortfalls of the present computer system are causing the state to lose tax revenue. Notwithstanding this lost revenue, the Commission has decided to operate its present computer system in a "maintain environment." That is, the Commission is not writing programs for its operating computer system to help collect from taxpayers who owe the state taxes but are not paying them.

The following represent shortfalls which could be addressed by the Commission using its present computer system.

1. The Commission could write programs to select corporations and businesses to audit, as well as abandoned property audits. The IRS uses a discriminate function analysis (DIF) to select taxpayer audits. According to the IRS, DIF has helped to increase the average tax assessment per audit by 700%.
2. The computer system could monitor sales tax prepayments for required compliance (see p. 41).
3. The system could monitor sales tax payments to determine if sales taxpayers exceed the allowable annual timely discount (see p. 51).
4. The computer could monitor and automatically assess interest for sales taxpayers with permanent extensions when they pay "late" under their extensions (see p. 53).
5. The computer could automatically generate delinquency assessments for sales taxpayers who pay their taxes "late" but do not include the required penalty and interest for "late" payment.
6. The system could monitor individuals granted extensions to file their income tax to ensure they file a final return (see p. 63).
7. IRM, with the help of other divisions, could compile and maintain a list of taxpayers in each tax who have not complied with the terms of previously granted

extensions. By compiling and updating such a list, the Commission could comply with state law disallowing extensions to taxpayers who failed to comply with previous extensions.

8. The system could automatically generate letters informing sales taxpayers, who have paid their sales tax late twice within a fiscal year, that they are required to post a bond (see p. 49).
9. IRM could match DSS delinquent accounts against the Tax Commission refunds to intercept tax refunds of individuals delinquent on their payments to DSS (see p. 83).

According to Commission officials, they have chosen to wait until the new system becomes operational to make many necessary computer changes. They indicated that a phase in approach could be better handled by the agency.

#### **RECOMMENDATION**

THE TAX COMMISSION SHOULD TAKE ADEQUATE  
STEPS TO AUTOMATE AS MANY TASKS AS  
POSSIBLE WITH THEIR PRESENT COMPUTER  
SYSTEM.

#### **Updating Tax Information on Computer**

The Tax Commission does not update its computer in a timely manner. When a return is received, it is not posted on the Commission's computer system for 5 to 20 days. Some returns, showing no tax due, are not processed for over 20 days. This means tax returns do not show on Commission records as being received in some instances for over 20 days after being filed.

Due to these problems, the Commission needs to study and reevaluate its decision to process 35% of sales tax and 30% of highway use tax returns manually, rather than through their revenue processing system (RPS). Also, the decision to work only one shift to keypunch all detailed tax return information, before payment information captured by the RPS is entered into the system, needs to be reconsidered. These

decisions need to be reevaluated due to the Commission's continued problems with issuing warrants and delinquency notices to taxpayers after the taxpayers have filed and paid their taxes. On an annual basis, the Commission improperly issues over 6,000 warrants against taxpayers with no tax liability (see p. 25). Also, approximately 23,000 delinquency notices have been issued to taxpayers after the Commission has received the taxpayers' returns.

According to Commission officials, improper warrant and delinquency notices are issued, in part, because the returns are not posted on the computer system for 5 to 20 days after they are received. This causes a 5- to 20-day time period in which Commission personnel cannot be sure whether a taxpayer has paid his taxes. Increased use of the Commission's three RPS machines could help to process payment information in one day.

Tax Commission officials stated that they decided to process large payment sales tax and highway use tax returns manually because the manual system is quicker in getting funds deposited in the state's bank accounts. Another reason the computer is not updated timely is because the precoded taxpayer information and payment information captured by the RPS is not placed on the Commission's mainframe computer until after all detailed information from the return is manually keypunched. While the taxpayer payment information could be run the day after the return is processed, keypunching in all of the detailed information requires an additional five to six days.

The Florida Department of Revenue (FDR) uses rapid revenue processing machines (of the same type as that owned by the Commission) for most of their sales tax returns. Each sales tax return has a unique taxpayer code and tax information preprinted on it that these machines read. (This is similar to the bank and account number code printed on personal checks.) The machine operator keypunches in the amount of the check sent in with the return. This

information is then transferred to Florida's main computer. At a later time, FDR personnel keypunch in the detailed information from the return. Since FDR began using these machines, its field office personnel now have next day payment information that previously took 30 to 45 days.

Increased use of the Tax Commission's RPS machines could allow Field Service warrant officers and Phone Power personnel to be able to obtain next day sales tax payment information from the Commission's computer. It would significantly reduce the amount of paper work necessary to issue the 6,000 improper warrants and the \$12,000 spent annually on warrant filing fees. Improper delinquency notices either mailed or phoned to sales taxpayers yearly who filed and paid their taxes timely would be reduced. Furthermore, by updating the computer more timely, Tax Commission personnel could work on "true" delinquencies. As of March 1986, the Commission had over \$22 million in outstanding warrants against taxpayers.

#### **RECOMMENDATIONS**

THE TAX COMMISSION SHOULD IMPLEMENT A METHOD OF PROCESSING TAX RETURNS AND UPDATING ITS COMPUTER IN A TIMELY MANNER, WHILE ALSO DEPOSITING FUNDS IN A TIMELY MANNER.

THE TAX COMMISSION SHOULD REEXAMINE ITS DECISION NOT TO RUN INFORMATION CAPTURED BY THE REVENUE PROCESSING SYSTEM ON ITS COMPUTER UNTIL ALL DETAILED INFORMATION FROM THE RETURN IS MANUALLY KEYPUNCHED INTO THE COMPUTER.

#### **Cross-Matching DSS Debts With Tax Refund Checks**

The state could possibly collect an estimated \$350,000 annually if Department of Social Services' (DSS) Food Stamps

and Aid to Families with Dependent Children (AFDC) delinquent debts were matched with tax refund checks issued by the Tax Commission. These debts consist, in part, of individuals who, by fraud or other means, obtained welfare benefits not due. Federal statute requires 50% of the money collected for Food Stamps debts and 100% of AFDC debts to be paid back to the federal government. Therefore, the state could possibly realize an actual savings of approximately \$104,000 annually. The collection of delinquent debts owed to DSS could also increase the public's confidence in social welfare programs.

Out of a sample of 136 individuals with Food Stamps and AFDC accounts delinquent for at least 90 days, 45 received individual income tax refunds in 1985. The Audit Council estimates 2,079 individuals who have had delinquent Food Stamps and AFDC accounts with DSS received tax refunds in 1985. One individual who owes the state \$2,846 received a tax refund of \$815 in 1985.

Other state agencies, such as the Health and Human Services Finance Commission (HHSFC), could also collect delinquent accounts through tax refund intercepts. The Audit Council found that one medical doctor, who has owed HHSFC over \$3,500 since 1982, received an income tax refund of over \$1,100 in 1985.

In 1979, North Carolina enacted legislation which allows "claimant agencies" to submit delinquent clients' names for tax refund offsets. Georgia passed a similar law in 1980. In 1982, the federal government passed the Federal Debt Collection Act, which provides for federal tax refund offset to collect federal debts of individuals with delinquent accounts. Further, the Audit Council in its 1985 audit of DSS recommended that legislation be enacted to garnish tax refunds of individuals owing money to the state. In addition, South Carolina has legislation allowing the Tax Commission to intercept refund checks of individuals



delinquent on their child support, student loan payments, and debts to the state's Employment Security Commission.

#### **RECOMMENDATION**

THE GENERAL ASSEMBLY SHOULD CONSIDER AMENDING TITLE 12 OF THE SOUTH CAROLINA CODE OF LAWS TO REQUIRE THE INTERCEPTION OF TAX REFUNDS TO INDIVIDUALS WHO ARE MORE THAN 90 DAYS DELINQUENT ON THEIR DEBTS TO THE DEPARTMENT OF SOCIAL SERVICES. SUCH LEGISLATION SHOULD REQUIRE DSS TO PROVIDE THE TAX COMMISSION THE NAMES, ADDRESSES, AND SOCIAL SECURITY NUMBERS OF SUCH INDIVIDUALS. THE GENERAL ASSEMBLY SHOULD ALSO CONSIDER AMENDING TITLE 12 OF THE CODE TO ALLOW ALL STATE AGENCIES TO SUBMIT THE NAMES OF DELINQUENT CLIENTS TO THE TAX COMMISSION FOR TAX REFUND INTERCEPTS.

#### **Nonverification of Cigarette Stamp Destruction**

The Tax Commission issues refunds to cigarette wholesalers and retailers for the destruction of cigarette tax stamps without verifying that the stamps were destroyed. The tax on cigarettes is paid by purchasing cigarette tax stamps at the rate of 7 cents per pack of 20. These stamps are required by state law to be affixed to each pack as proof the tax is paid. In 1985, over \$265,000 for approximately 3.8 million stamps was refunded by the Commission without verifying the stamps were destroyed. In order to be refunded money for stamps on cartons and packs of cigarettes returned to the manufacturer, the Commission only requires the wholesaler or retailer to present a statement from the manufacturer that they received the cigarettes.

The Audit Council examined all Commission refunds to cigarette wholesalers and retailers in 1985. There were 190 refunds issued without Commission verification of stamp destruction. One refund of \$22,441 included \$20,824 for stamps which Commission officials did not observe being destroyed. (The destruction of \$1,617 worth of stamps was observed by a Commission field agent.)

The Tax Commission does not have regulations or policies requiring refunds for destroyed South Carolina cigarette tax stamps only when Commission officials observe their destruction. Their present system only verifies that wholesalers or retailers returned "X" number of cigarettes to the manufacturer. In contrast, Commission policies require one of its field agents to verify that documentary stamps are destroyed or canceled regardless of the dollar amount before issuing a documentary stamp refund. Without verifying the destruction of refunded cigarette stamps, the Tax Commission cannot assure that such stamps are not reused or sold.

#### **RECOMMENDATION**

THE TAX COMMISSION SHOULD TAKE STEPS TO REQUIRE VERIFICATION BY A COMMISSION OFFICIAL OF THE DESTRUCTION OF SOUTH CAROLINA CIGARETTE TAX STAMPS BEFORE ISSUING REFUNDS TO RETAILERS AND WHOLESALERS.

#### **Savings From Annual Mailing of Tax Forms**

The Tax Commission could save \$80,000 annually on postage by mailing sales tax returns and other monthly and quarterly tax forms to businesses on an annual basis. Presently, the Commission mails over 64,000 tax forms to businesses on a monthly basis.

The Tax Commission presently mails annually to businesses a full-year's supply of corporate withholding tax

forms and corporate declared estimated tax forms. In addition, self-employed individuals are annually mailed a full-year's supply of individual declared estimated tax forms.

If the Tax Commission would mail a full-year's supply of tax forms to businesses annually instead of mailing the forms monthly (or quarterly in some cases), the Commission would save \$80,000 per year in postage.

#### **RECOMMENDATION**

THE TAX COMMISSION SHOULD ANNUALLY MAIL  
TO BUSINESSES A FULL-YEAR'S SUPPLY OF  
ALL NECESSARY TAX FORMS.

#### **Complaint Handling**

The Tax Commission does not have an adequate system to track and analyze complaints filed by taxpayers. Complaint logs, files, and standard complaint forms are not maintained by the Commission or division directors.

A system to track and analyze complaints filed with field offices and the state office would help the Commission address areas of taxpayer concern. Also, such systems would provide the Commission with information needed to improve its operation. For example, the process of filing warrants against taxpayers with no tax liability has been a source of taxpayer complaints since 1983. Yet, the problem still exists (see p. 25).

Other areas where taxpayer complaints need to be examined by the Commission are the audit and collections process. An analysis of tax complaints could not be conducted since adequate records to create an audit trail are not maintained.

#### **RECOMMENDATION**

THE TAX COMMISSION SHOULD DEVELOP FORMAL  
PROCEDURES FOR ALL DEPARTMENTS TO FOLLOW

WHEN COMPLAINTS ARE FILED. THESE  
PROCEDURES SHOULD INCLUDE THE  
MAINTENANCE OF A STANDARD COMPLAINT  
FORM, LOG, AND COMPLAINT FILES. THESE  
RECORDS SHOULD INCLUDE: COMPLAINANT;  
NATURE OF COMPLAINT; DATE OF CONTACT;  
ACTION TAKEN AND FOLLOW-UP.

## **APPENDICES**

## **APPENDIX A**

### **Revenue Collections and Expenditures**

The Tax Commission collected over \$2 billion in revenues in FY 84-85. As indicated by Table 5, three taxes - individual income, sales and use tax, and corporate income tax - accounted for approximately 86% of the revenue collected for the General Fund (over 77% of the revenue collected for all funds). Annual expenditures are detailed in Table 4.

**TABLE 4****TAX COMMISSION TOTAL ACTUAL AND ESTIMATED EXPENDITURES**

EXPENDITURES BY PROGRAM	FY 84-85	FY 85-86*	FY 86-87*
<b>ADMINISTRATIVE &amp; PROGRAM SUPPORT</b>			
A. ADMINISTRATIVE			
PERSONAL SERVICE	\$1,177,628	\$1,385,779	\$1,437,703
OTHER OPERATING EXPENSES	437,025	375,874	2,103,104
TOTAL ADMINISTRATIVE	\$1,614,653	\$1,761,653	\$3,540,807
B. INFORMATION RESOURCE MANAGEMENT			
PERSONAL SERVICE	\$1,176,441	\$1,859,388	\$1,917,393
OTHER OPERATING EXPENSE	552,071	596,109	596,109
SPECIAL ITEMS	---	---	500,000
TOTAL IRM	\$1,728,512	\$2,455,497	\$3,013,502
C. SERVICE			
PERSONAL SERVICE	\$773,473	\$872,364	\$894,485
OTHER OPERATING EXPENSES	361,718	402,849	402,849
TOTAL SERVICE	\$1,135,191	\$1,275,213	\$1,297,334
TOTAL ADMINISTRATIVE AND PROGRAM SUPPORT	\$4,478,356	\$5,492,363	\$7,851,643
<b>AUDIT AND COLLECTIONS</b>			
A. OFFICE SERVICES**			
PERSONAL SERVICE	\$2,872,879	\$3,220,302	\$3,322,056
OTHER OPERATING EXPENSES	1,824,678	1,872,498	1,802,154
SPECIAL ITEM	243,517	---	---
TOTAL OFFICE SERVICES	\$4,491,074	\$5,092,800	\$5,124,210
B. PROPERTY			
PERSONAL SERVICE	\$979,792	\$1,064,133	\$1,099,526
OTHER OPERATING EXPENSES	199,249	209,004	209,004
SPECIAL ITEMS	61,885	68,953	65,000
TOTAL PROPERTY	\$1,240,926	\$1,342,090	\$1,373,530
C. FIELD SERVICES			
PERSONAL SERVICES	\$6,080,110	\$6,969,714	\$7,199,275
OTHER OPERATING EXPENSES	1,362,771	1,434,853	1,434,853
SPECIAL ITEM	---	250,000	250,000
TOTAL FIELD SERVICES	\$7,442,881	\$8,654,567	\$8,884,128
TOTAL AUDIT & COLLECTIONS	\$13,624,881	\$15,089,457	\$15,381,868
EMPLOYEE BENEFITS			
A. SALARY INCREMENTS	---	\$23,093	\$46,186
B. FRINGE BENEFITS	\$2,389,894	2,865,342	2,945,160
TOTAL EMPLOYEE BENEFITS	\$2,389,894	\$2,888,435	\$2,991,346
NONRECURRING APPROPRIATION	\$467,374	\$896,074	---
TOTAL TAX COMMISSION	\$20,960,505	\$24,366,329	\$26,224,857
TOTAL POSITIONS AUTHORIZED	652	711	711

\* ESTIMATED OPERATING BUDGET

\*\* INCLUDES INCOME &amp; ESTATE AND SALES &amp; LICENSE UNITS

SOURCE: STATE BUDGET DOCUMENTS

TABLE 5

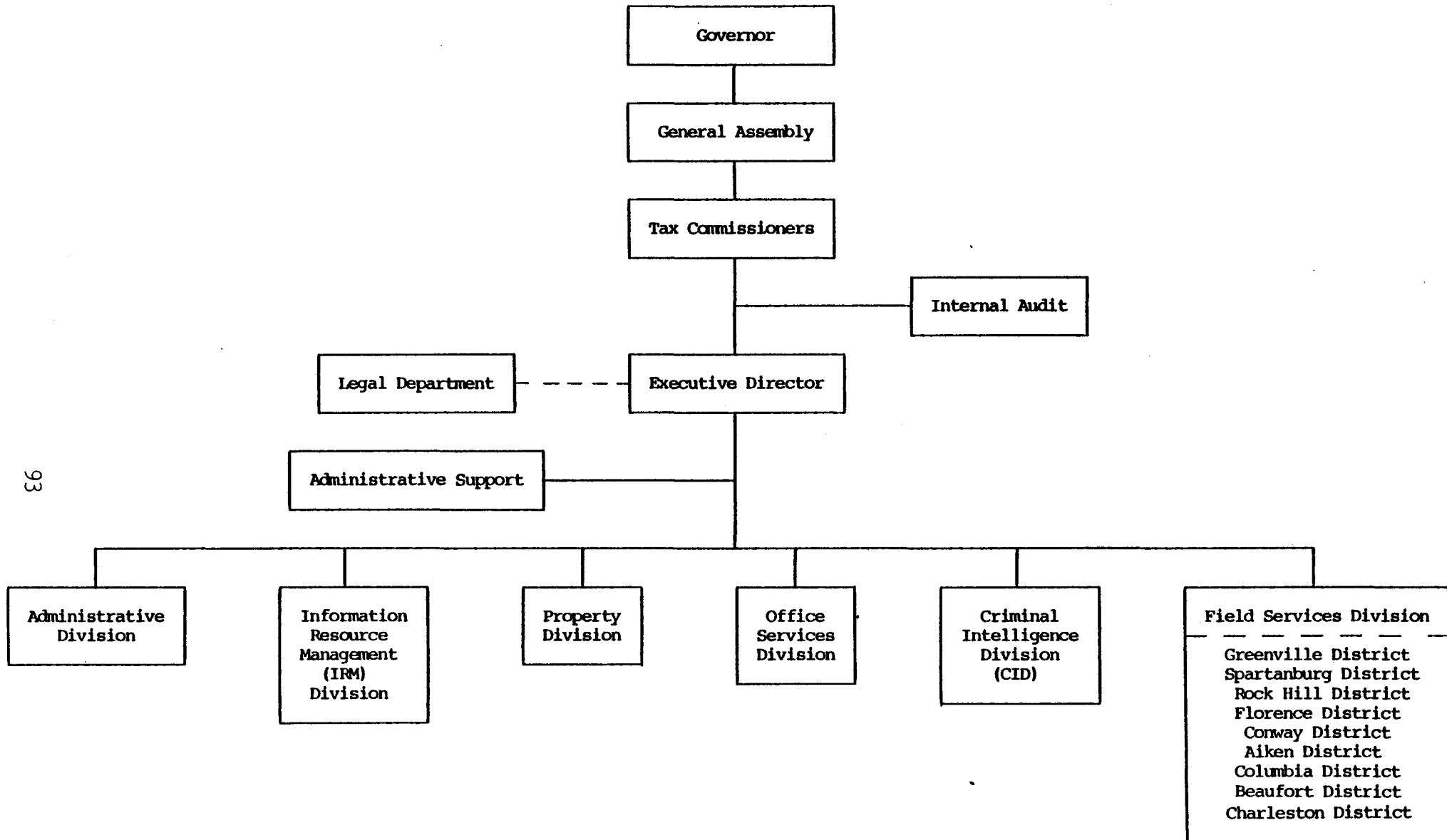
TAXES COLLECTED BY THE SOUTH CAROLINA TAX COMMISSION

	FY 80-81	FY 81-82	FY 82-83	FY 83-84	FY 84-85	% of FY 84-85 Taxes Collected
RECEIPTS-GENERAL FUND						
INCOME TAX-INDIVIDUAL	\$570,988,887	\$641,770,918	\$718,862,771	\$795,480,493	\$850,813,834	35.56%
SALES AND USE TAX	616,076,916	646,544,232	684,390,838	790,133,373	820,533,592	34.29
INCOME TAX-CORP.	148,508,219	127,676,624	124,132,398	140,781,962	179,917,977	7.52
BEER AND WINE TAX	51,432,850	53,766,585	59,773,002	57,126,321	59,358,975	2.48
ALCOHOLIC LIQUOR TAX	37,219,067	37,807,474	41,620,285	41,709,247	42,620,586	1.78
TOBACCO PROD. & PLAYING CARDS	--	--	--	29,763,664	29,877,536	1.25
ESTATE TAX	11,437,927	12,633,728	14,257,775	17,805,222	22,617,427	0.95
DOCUMENTARY TAX	10,427,187	10,139,913	11,702,916	16,785,973	16,359,744	0.68
GASOLINE TAX-COUNTIES	14,910,492	14,647,264	14,331,921	15,431,329	15,943,519	0.67
SOFT AND BOTTLED DRINK TAX	13,396,125	13,860,248	13,838,959	13,192,015	14,969,762	0.63
CORP. LICENSE TAX	15,181,487	17,666,463	18,203,157	8,014,221	14,438,246	0.60
ELECTRIC POWER TAX	12,538,920	12,627,214	12,435,320	13,076,362	13,411,125	0.56
INCOME TAX-CORP.: TEXTILES	--	--	--	13,701,507	12,232,971	0.51
UTILITIES TAX	--	--	--	13,322,855	10,564,150	0.44
CASUAL EXCISE TAX	--	--	7,185,816	9,120,187	8,804,979	0.37
BANK TAX	3,889,728	3,876,069	5,116,100	4,838,620	7,632,432	0.32
COIN OPERATED DEVICE TAX	2,091,483	1,975,101	8,370,840	6,046,393	5,756,105	0.24
COMMERCIAL NUCLEAR WASTE	--	--	--	3,902,892	4,855,891	0.20
RETAILERS LICENSE TAX	704,853	726,950	1,120,827	1,193,237	3,776,169	0.16
ADMISSION TAX	3,500,000	3,500,000	3,500,000	3,500,000	3,500,000	0.15
BINGO	--	8,352	1,957,562	2,550,777	2,650,590	0.11
UNCLAIMED PROPERTY FUND	--	--	1,794,798	523,000	2,336,000	0.10
DOMESTIC INSURANCE TAX	1,951,328	1,656,596	2,123,380	1,977,482	2,129,380	0.09
REGISTRATION FEES-PSC	--	--	1,274,037	1,375,546	1,511,637	0.06
GIFT TAX	710,370	714,318	980,478	1,121,006	1,496,355	0.06
PRIVATE CAR LINE TAX	800,418	1,075,435	1,077,025	1,135,234	1,056,557	0.04
AIRCRAFT TAX	--	--	270,773	152,905	457,936	0.02
PUBLIC RECREATION TAX	2,500	2,300	2,000	1,725	1,275	0.00
UNCLAIMED PROP. DIV. & INT.	--	--	--	1,524	325	0.00
BLDG. & LOAN ASS. TAX	275,996	59,474	(67,669)	19,241	(12,371)	--
FLIGHT EQUIPMENT	268,280	245,768	--	--	--	--
BUSINESS LICENSE TAX	29,543,958	30,199,089	29,672,552	--	--	--
FIREWORKS LICENSE TAX	21,800	17,800	6,200	--	--	--
BEDDING FUND-REPEALED 80-81	(29)	--	--	--	--	--
RECEIPTS - REVENUE FOR						
OTHER FUNDS						
GAS. TAX-HWY. DEPT.	\$143,914,283	\$167,959,204	\$174,245,223	\$184,291,554	\$190,412,254	7.96%
SPECIAL FUEL TAX-HWY. DEPT.	22,736,623	27,639,458	29,519,831	33,307,521	35,979,360	1.50
2% ACCOMMODATIONS TAX	--	--	--	--	8,641,159	0.36
HIGHWAY USE TAX-HWY. DEPT.	2,541,061	2,756,714	2,914,887	3,642,938	3,743,152	0.16
ADMISSION TAX-PRT	1,201,951	2,238,483	1,945,072	2,256,461	2,368,395	0.10
GAS TAX-WILDLIFE RES.	719,392	838,848	859,915	925,880	956,611	0.04
REGISTRATION FEES HWY. DEPT.	696,768	724,544	742,725	810,755	932,398	0.04
FOREST RENEWAL TAX	--	--	471,957	542,902	264,344	0.01
ADMISSION TAX-WILDLIFE RES.	7,075	7,984	8,667	7,532	7,792	0.00
AMMUNITION TAX-WILDLIFE RES.	74,680	69,318	74,038	88,026	(35,479)	--
REGISTRATION FEES-PSC	1,162,401	1,225,407	--	--	--	--
UNCLAIMED PROPERTY FUND	463,622	651,879	--	--	--	--
TOTAL	\$1,719,396,618	\$1,837,309,754	\$1,988,716,376	\$2,229,657,882	\$2,392,882,690	

Source: State Budget Documents



SOUTH CAROLINA TAX COMMISSION ORGANIZATION CHART



**APPENDIX B**  
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## APPENDIX C

### GLOSSARY

**abandoned property** - property held by a financial institution, company, or individual for which the legal owner cannot be found.

**assessment** - 1. the determination of the amount of tax, penalties and interest due on a tax account when a taxpayer fails to file or underpays a liability. 2. apportioning or levying the amount of tax the taxpayer owes.

**audit trail** - the ability to trace an audit transaction or document.

**CID** - the Tax Commission's Criminal Intelligence Division, Responsible for investigating suspected tax fraud.

**DIF** - discriminant function analysis, program used by the IRS, based on weighted criteria, to select taxpayer audits most likely to yield large tax assessments.

**distrain** - the act of seizure or levy.

**domestic corporation** - a corporation headquartered in South Carolina.

**foreign corporation** - a corporation doing business in South Carolina but headquartered in another state.

**garnish/garnishment** - attachment of wages to pay a legal obligation to the Tax Commission.

**IRM** - the Tax Commission's Information Resource Management Division.

**IRS** - the United States Internal Revenue Service.

**lien/levy** - a security interest in property to secure a debt owed to the Tax Commission.

**miscellaneous taxes** - refers to small taxes, such as admissions, business licenses, soft drinks (crown & stamp), electric power, documentary, beer & wine, and alcoholic liquor taxes.

**phone power** - department responsible for calling taxpayers to remind them of a tax liability.

**prepayment estimate or requirement** - requirement that certain taxpayers pay a portion of tax owed prior to its normal due date.

**private car line and airline taxes** - tax paid by railroads and airlines based on the amount of travel conducted in the state.

**probable cause** - legal determination that there is reasonable cause to believe a crime was committed and the accused committed it.

**RAR** - revenue agent reports; IRS audits.

**RPS** - revenue processing system, computerized system used to automatically capture taxpayer information precoded on tax returns and payment information.

**surety bond** - a financial bond guaranteeing an obligation.

**Tax Amnesty Program** - allowed taxpayers who had not filed returns, had delinquent tax returns, or had not paid back taxes an opportunity to pay their tax liabilities without penalties or criminal prosecution.

**use tax** - tax applied to out-of-state purchases by in-state users or in-state purchases from out-of-state sellers.

**warrant** - document filed in county court houses which allows the Commission to seize property to satisfy tax liabilities.

**withholding** - employee income tax withheld by employers each payroll period and remitted to the Tax Commission either directly or through bank deposits.

APPENDIX D

State of South Carolina

**South Carolina Tax Commission**

P. O. BOX 125  
COLUMBIA, S. C. 29214



October 22, 1986

Mr. George L. Schroeder, Director  
Legislative Audit Council  
620 NCNB Tower  
Columbia, South Carolina 29201

Dear Mr. Schroeder:

Attached hereto is the Commission's response to the Legislative Audit Council's report on the operations of the Tax Commission.

We appreciate your cooperation.

Yours very truly,

A handwritten signature in dark ink, appearing to read "E. Gregorie Frampton". The signature is stylized with a large, sweeping initial "E" and a cursive "Frampton".

E. Gregorie Frampton  
Executive Director

EGF:bb  
Attachment

## SOUTH CAROLINA TAX COMMISSION

### RESPONSE TO THE LEGISLATIVE AUDIT COUNCIL

#### INTRODUCTION

The South Carolina Tax Commission totally supports the process of external review of State agencies as a means to improve the effectiveness of government operations serving the citizens of South Carolina. Any comments the Commission makes concerning the conclusions or methodology of the Council should not be construed as criticism of the necessity for external review. The Tax Commission has demonstrated its commitment to improve operations by completely cooperating with Council during its review and by previously obtaining other external reviews of its operation.

As Council's report reflects, the Commission has made great strides in improving its operations and is committed to correcting, in a planned environment, those areas pointed out by Council as needing improvement. The Commission is dedicated to becoming one of the most effective revenue agencies in the United States and appreciates the General Assembly's support during this transition. The Commission welcomes any assistance by other agencies, such as the Council, that may be provided in the future.

#### COUNCIL'S REPORT

The Commission emphasizes that Council's report only comments on a portion of the Commission operations and that the majority of Commission's functions are effectively conducted. As a result of external review, in 1983, the Commission began a total reorganization and in December of 1984, initiated a complete revision of its computer systems. The Commission has elected to implement these agency-wide changes utilizing a planned structure to prevent disruption of essential services. As a result, most of the needed improvements noted by Council were previously identified by the Commission and are scheduled for implementation or already completed.

Council has addressed 54 areas of operations of the Commission. Of those, 67% were previously identified by the Commission and 18% require legislation or there is a difference of legal interpretation. 39% of the areas addressed have been corrected and 26% are being corrected or will be corrected in the new Commission computer system. 20% are being evaluated or require legislation. The Commission disagrees with 8 issues.

The Commission will issue a corrective action report as recommended by Council.

#### SPECIFIC ISSUES

In the following, the Commission addresses each point noted by Council.

Page 8 PAYMENT DUE DURING AMNESTY

No violation of law took place. The majority of the applications were received during the last week and some revenue was allocated to other periods.

The Commission has the statutory authority to accept the payments noted. The Amnesty Program cannot be totally segregated from ongoing existing Commission authority.

Page 9 PERSONAL CHECKS

The Commission did not state that it would accept checks; however, once received, the Commission did not utilize personnel to send checks back. All bad checks have been assessed and amnesty was not allowed.

Page 10 AUDITS CONDUCTED DURING AMNESTY

The Commission disagrees with Council's conclusion. Audits conducted on prior years' liabilities were eligible for amnesty.

Page 10 TAX CASE INVESTIGATED AND PROSECUTED

The Commission disagrees with Council's conclusion. The corporation applying for amnesty is a separate legal entity and eligible for amnesty. The corporation was never the subject of a state tax criminal prosecution or investigation. Furthermore, the individual in question was not under criminal investigation at the time of the corporation's application as he had been previously prosecuted and convicted. The escape from criminal prosecution would appear to have been the fear guarded against in the amnesty legislation, which obviously did not occur in this case.

Page 10 PART PAY AGREEMENTS

The stated purpose of the General Assembly in granting an amnesty period was to "encourage the voluntary disclosure and payment of taxes owed", Section 12-3-260, Code of Laws of South Carolina 1976. This enabling legislation provided few special provisions for the administration of amnesty. It is well established that the Commission, as well as any administrative agency, is vested with the authority to carry out the legislative will as expressed by statute, Hay v. South Carolina Tax Commission, 273 S.C. 269, 255 SE2d 837.

Accordingly, amnesty was administered pursuant to the existing authority and powers of the Commission. The provision for payments under Section 12-3-260, supra., are not dissimilar to requirements for payment of any tax at its due date. In effect, a new filing date was established for those taxpayers who qualified. Thus, the Commission administered this provision as it has all other tax legislation. This was done with the spirit to conform with the legislative intent to further promote voluntary compliance.

A quarter of a million dollars was collected that would not have been remitted and \$218,000 more will be collected. The Commission will utilize all authority granted by law to maximize revenue collections.

Page 11 AMNESTY AGREEMENT VIOLATIONS

Those individuals violating their agreements have had amnesty privileges revoked and collection activities have been instituted.

(CORRECTED)

Page 12 TAXPAYERS NOT FILING UNDER AMNESTY

During FY 86, the Commission has identified over 4,000 additional nonfilers, increased garnishment of wages 25%, increased warrant collections 56%, identified and offset against refunds an additional \$3.6 million from 23,000 taxpayers, and increased audit activity 15%. In addition, a phone power collection system has been installed and we have entered into a contract with an out-of-state collection service.

The Commission has increased enforcement, as promised, and will continue to improve efforts.

(CORRECTED AND FURTHER IMPROVEMENT IS BEING MADE)

Page 14 CONCLUSION

Commission records reflect only 32% of the dollars collected under amnesty could have been identified by the Commission. Warrants have increased because more delinquent taxpayers are being identified.

Page 15 RECOMMENDATIONS

We concur.

Page 15 AUDIT SELECTION PROGRAM

In August 1986, the Commission began utilizing an IRS selection program and is one of the first states to be approved to do so. Steps have been taken to improve sales tax audit selection.

(CORRECTED AND FURTHER IMPROVEMENTS WILL BE MADE WITH THE COMMISSION'S NEW COMPUTER SYSTEM.)

Page 16 FIELD AUDIT COVERAGE

Commission audit coverage has increased 74% since Fiscal Year 1984. Current coverage in Sales Tax exceeds 2% and continued improvement will be made. Audits conducted have shifted to more productive areas.

(CORRECTED AND FURTHER IMPROVEMENT IS BEING MADE)



Page 18 USE OF FIELD AUDITORS TIME

The percentage of time spent on auditing is 67%, which compares favorably with the IRS. In addition, Commission auditors spend 3.5% of their time with public assistance. New selection techniques will assist in increasing direct audit time and public assistance will continue.

(CORRECTED AND FURTHER IMPROVEMENT IS BEING MADE)

Page 19 COMPARISON OF DISTRICT AUDIT PRODUCTIVITY

The Commission does analyze district productivity. The Commission will continue to improve its analysis to enhance productivity.

(CORRECTED)

Page 20 RECOMMENDATIONS

We concur.

Page 21 WAIVER OF TAX PENALTIES

The Commission has instituted an agencywide procedure for handling penalties. Prior to September 1985, the Commission had the authority to waive interest. Legislation changing this authority was recommended by the Commission.

(CORRECTED)

Page 24 RECOMMENDATIONS

We concur.

Page 24 DELINQUENT FIELD COLLECTIONS

The Commission has taken steps to improve delinquent collections and will continue to improve procedures with automation.

(CORRECTED AND FURTHER IMPROVEMENT IS BEING MADE)

Page 25 WARRANTS ISSUED IN ERROR

Warrants issued in error represent only three tenths of one percent of all returns received and are the result, primarily, of taxpayer errors and taxpayers not responding to notices. The Commission has taken steps to improve procedures and will continue to do so.

(CORRECTED AND MORE IMPROVEMENTS WILL RESULT  
WITH ADDITIONAL AUTOMATION.)

Page 26 RECOMMENDATIONS

We concur.

Page 27 WARRANT COLLECTION PRIORITY ORDER

The Commission places emphasis on large dollar warrants; however, more automation will improve this process.

(IN PROCESS OF BEING CORRECTED.)

Page 27 RECOMMENDATIONS

We concur.

Page 28 SYSTEM FOR PROSECUTING TAX EVADERS

The Commission now has such a policy in effect. All cases where there are substantial indications of criminal fraud are forwarded to the Attorney General for review.

Council has cited five (5) examples in their report. Council has not stated that these cases should have been prosecuted, but only indicates outside sources should have been sought for review. Commission procedures now followed are similar to other state agencies within South Carolina, the Internal Revenue Service and Revenue Departments of other states.

In addition, when Commission performance is compared to its counterpart, the Commission reflects most favorably. Our productivity was more than three (3) times that of the comparable federal agency, the IRS.

The Commission does forward to the appropriate prosecutorial body for review, all cases where there are substantial indications of criminal wrongdoing. In an effort to continue its improvement and assure all tax evasion is dealt with appropriately, the Commission has sought the assistance of the Attorney General and will continue to do so to further refine the referral process.

(CORRECTED)

Page 31 FOLLOW UP OF INVESTIGATIONS

The Commission disagrees with Council and feels that the cases cited have been followed up. The Commission will review procedures for improvement.

(CORRECTED)

Page 32 REFERRALS TO LICENSING BOARDS

The Commission has previously recommended legislation to revoke professional licenses for failure to pay taxes.

(LEGISLATION RECOMMENDED)

Page 34 RECOMMENDATIONS

We concur.

Page 35 PERSONAL BUSINESS WITH COMPANY WHILE WAIVING PENALTIES

The Commission began development of a Code of Conduct, a part of which contains ethics violation procedures, before Council's review and is one of the few revenue departments in the country now having such a code. The Commission will discuss the matter with the appropriate authorities.

(WILL BE EVALUATED.)

Page 37 RECOMMENDATIONS

(WILL BE EVALUATED.)

Page 37 ENFORCEMENT OF PRIVATE CAR LINE AND AIRLINE TAXES

This problem was identified prior to Council's review and is corrected.

(CORRECTED)

Page 38 RECOMMENDATIONS

We concur.

Page 41 ENFORCEMENT OF SALES TAX PREPAYMENT LAWS

The Commission had limited enforcement of the prepayment laws but began proper enforcement prior to Council's examination of this area.

(CORRECTED)

Page 41 PENALTIES DUE TO LACK OF SALES TAX PREPAYMENT  
(IN THE PROCESS OF BEING CORRECTED.)

Page 43 INTEREST FROM PREPAYMENT OF SALES TAX

Where allowed by law, these accounts have been assessed.  
(CORRECTED)

Page 43 ASSESSMENT OF NON-PREPAID SALES TAX

(THIS IS IN THE PROCESS OF BEING CORRECTED.)

Page 44 TIMELY PAYMENTS DISCOUNTS TAKEN ON SALES TAX NOT PREPAID  
(WILL REQUIRE LEGISLATION.)

Page 45 RECOMMENDATIONS

- (1) We concur
- (2) The Commission will evaluate
- (3) We concur
- (4) We concur.

Page 45 BUSINESS FAILING TO FILE RETURNS

The delinquent returns cited by Council represent 1.8% of the returns filed for that period and contain many accounts that have no sales for the period. Improvements will be made.

(WILL BE CORRECTED IN THE COMMISSION'S NEW  
AUTOMATED SYSTEMS.)

Page 46 RECOMMENDATIONS

We concur.

Page 47 DELINQUENT FILERS NOT PENALIZED  
(CORRECTED)

Page 47 RECOMMENDATION

We concur.

Page 48 CLOSED BUSINESSES

(CORRECTED)

Page 48 RECOMMENDATION  
We concur.

Page 49 DELINQUENT FILERS BONDS

The Commission will evaluate this section in light of other authorities to revoke licenses and upcoming automation.

Page 49 RECOMMENDATION

- (1) will evaluate
- (2) will evaluate
- (3) will evaluate in light of taking resources from prosecuting cases of substantial tax fraud.

Page 50 SALES TAX ERROR LIST

The sales tax error list has been reduced 63% and new automation will reduce the resources required.

(CORRECTED AND FURTHER IMPROVEMENT IS BEING MADE)

Page 51 SALES TAXPAYERS' PENALTIES  
(IN THE PROCESS OF BEING CORRECTED.)

Page 52 RECOMMENDATIONS

We concur.

Page 53 PERMANENT SALES TAX FILING EXTENSIONS  
(CORRECTED)

Page 54 RECOMMENDATIONS

- (1) we concur
- (2) we concur
- (3) we disagree in disallowing discounts if there are bona fide reasons for taxpayers requesting extensions. We concur that interest should be required on extensions of prepayments.

Page 55 MULTILLOCATION TAXPAYERS

Current law requires allocation of funds by location even though administratively burdensome.

Page 57 RECOMMENDATIONS

(LEGISLATION REQUIRED)

Page 58 REPORTING ON A 13 PERIOD BASIC

The 13 period reporting benefits the State, through interest earnings, and the taxpaying public.

Page 58 RECOMMENDATIONS

We concur.

Page 59 CORPORATIONS NOT FILING INCOME TAX RETURNS

The majority of these assessments are issued for defunct corporations with little likelihood of collection; however, steps have been taken to improve this process.

(CORRECTED)

Page 60 SYSTEM TO ASSESS CORPORATE NONFILERS

A system to correct this problem was begun prior to Council's review and is implemented.

(CORRECTED)

Page 61 RECOMMENDATIONS

We concur.

Page 61 ESTIMATED TAX PAYMENTS AND EMPLOYEE WITHHOLDING

All the improvements that can be made within the constraints of our current system will be implemented and extensive improvement is planned for these areas in the Commission new automated systems.

(IN THE PROCESS OF BEING CORRECTED.)

Page 61 BONDING OF INDIVIDUAL INCOME WITHHOLDING ACCOUNTS

(WE WILL EVALUATE.)

Page 62 RECOMMENDATIONS

(THE COMMISSION WILL EVALUATE.)

Page 63 INDIVIDUAL NONFILERS

The Commission has made many improvements prior to Council's review. The Commission utilizes Federal information to track taxpayers from one year to the next.

(CORRECTED AND FURTHER IMPROVEMENT IS BEING MADE)

Page 63 RECOMMENDATIONS

We concur.

Page 63 INCOME TAX EXTENSIONS

The Commission has a system in place to monitor extensions.  
(CORRECTED)

Page 64 RECOMMENDATIONS

We concur.

Page 65 PROCESSING OF FEDERAL REVENUE AGENTS REPORTS

The number of revenue agents reports processed has increased 143% compared to 3 years ago.  
(CORRECTED)

Page 66 RECOMMENDATIONS

We concur.

Page 67 AUDITS FOR ABANDONED PROPERTY

The Commission improved its abandoned property program prior to Council's review and has assessed over \$1 million in additional tax. More improvements will be made and all dollars will be collected since there is no statute of limitations; however, we find no basis for Council's 20 million estimate. Legislation will be recommended to strengthen collection procedures.

(CORRECTED AND FURTHER IMPROVEMENT IS BEING MADE)

Page 68 REPORTING OF ABANDONED PROPERTY

The Commission is taking steps to improve this process.  
(IN THE PROCESS OF BEING CORRECTED.)

Page 70 RECOMMENDATIONS

We concur.

Page 71 SYSTEM FOR NOTIFYING AND ASSESSING DELINQUENT FILERS

This problem will be corrected in the Commission's new automated tax system.  
(IN THE PROCESS OF BEING CORRECTED.)

Page 72 RECOMMENDATIONS

We concur.

Page 73 STATE AGENCIES PAYING SALES TAX

We will evaluate.

Page 74 RECOMMENDATION

We will evaluate; however, it must be pointed out that exemption of state agencies automatically exempts all Federal agencies.

Page 74 BENEFITS OF INDIVIDUAL INCOME TAX CONFORMITY

The Commission is confident that conformity not only benefited the Commission but also benefited millions of South Carolina citizens.

Page 75 NEUTRALITY OF 1985 INDIVIDUAL INCOME TAX REVISION

The Commission's methodology was adequate and the final results confirm that conformity was revenue neutral.

Page 77 HIGHWAY USE TAX

The highway use tax is very burdensome to the public; however, any revisions should be considered in light of the National Governors' Association's current efforts to resolve the problem.

Page 78 RECOMMENDATIONS

- (1) we concur
- (2) the Commission is currently in discussion with consultants
- (3) we concur
- (4) we will evaluate.

Page 79 USE OF PRESENT TAX COMMISSION COMPUTER

The new Commission automated system addresses all points made by Council. If the Commission finds the cost benefit analysis is significantly positive on any new programs, they will be implemented in both the old and new computer environment.

(WILL EVALUATE)

Page 81 RECOMMENDATIONS

We agree to the extent that there is significant benefit beyond cost.

Page 81 UPDATING TAX INFORMATION ON COMPUTER

The Commission agrees with the intent of Council's statements and will enhance the timely posting of information within the constraints of the existing system. This problem will be resolved in the Commission's new automated system.

(IN THE PROCESS OF BEING CORRECTED.)

Page 83 RECOMMENDATIONS

- (1) we concur
- (2) will evaluate

Page 83 CROSS MATCHING DSS DEBTS WITH TAX REFUND CHECKS

The Commission has proposed legislation to cross match debts of all state agencies.

(LEGISLATION PROPOSED)

Page 85 RECOMMENDATIONS

We concur.

Page 85 NON-VERIFICATION OF CIGARETTE STAMPS DESTRUCTION

The Commission will continue to allow affidavits from cigarette manufacturers as the basis for refunds as the stamps cannot be reused because they are affixed to the packs. The Commission will audit manufacturers periodically to confirm receipt and destruction.

Page 86 RECOMMENDATIONS

We disagree because current procedures are adequate.

Page 86 SAVINGS FROM ANNUAL MAILING OF TAX FORMS

The Commission is conducting a cost benefit analysis.

Page 87 RECOMMENDATION

We will evaluate.

Page 87 COMPLAINT HANDLING

The Commission implemented a Problem Resolution Staff 18 months ago that not only handles complaints but tracks these complaints for trends. As a result, many improvements have been made. A special Post Office Box 11189 is now available to taxpayers who are unable to resolve their problems through normal channels.

(CORRECTED AND FURTHER IMPROVEMENT IS BEING MADE)

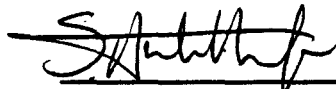
Page 87 RECOMMENDATION

We concur.

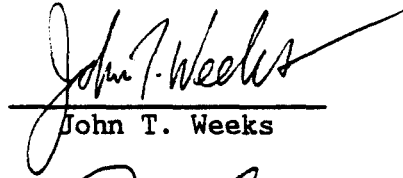


## CONCLUSION

The Tax Commission has responded to points made by Council in detail form and has not attempted to respond to all statements and comments made by Council. The Commission has made significant progress in modernizing the agency and will continue to dedicate itself to this task. The Commission appreciates the support given by the General Assembly that has enabled us to make the progress to date and will publish a corrective action report in the immediate future for the General Assembly's consideration. We will be happy to discuss any concern, in detail, with members of the General Assembly.



S. Hunter Howard, Jr.



John T. Weeks



John M. Rucker

October 22, 1986